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82-1905

In the

Supreme Court of the United States

OCTOBER TERM, 1982

SUN CHEMICAL CORPORATION, A Delaware Corporation, [Successor In Interest By Merger To Kollsman Instrument Corporation],

Petitioner,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PAUL A. TESCHNER
39 South LaSalle Street
Chicago, Illinois 60603
(312) 332-0346
Counsel For Petitioner

Of Counsel:
TESCHNER PROFESSIONAL CORPORATION
39 South LaSalle Street
Chicago, Illinois 60603

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I

QUESTIONS PRESENTED

1. Whether a formal claim for refund of income taxes—which was considered on its merits and denied in written revenue agent reports—is insufficient to support this refund suit because (as the Court of Appeals held) "* * * it * * * does not adequately apprise the I.R.S. that the 'claim' itself is operative whether or not a later disallowance occurs." (App. A, *infra*, A11).

2. Whether a 1978 order of the Court of Claims granting the Government's motion for a partial summary judgment is *res judicata* and currently unreviewable because (as the Court of Appeals held) that order was "* * * a final judgment appealable to the Supreme Court through an application for certiorari." (App. A, *infra*, A12).

3. Whether the aforementioned 1978 order of the Court of Claims erroneously held that a prior Tax Court decision, which redetermined a deficiency in Taxpayer's 1961 income taxes, was *res judicata* of Taxpayer's refund claim based upon an increased 1964 net operating loss and its carryback to 1961 because (as the Court of Claims held) Taxpayer "* * * could have raised in the Tax Court suit the issue it now seeks to litigate in this court, but failed to do so." (App. B, *infra*, A16).

4. Whether the judgment of the Court of Appeals and the 1978 order of the Court of Claims present questions concerning the jurisdictional relationship between the Tax Court and refund courts, principles of estoppel by judgment applicable to income tax cases, and adequacy of claims for refund, which are of sufficient general importance and concern to warrant plenary review by this Court.

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RULE 28.1 LISTING

Sun Chemical Corporation ["Petitioner"] has no parent corporation. The following corporations are affiliates of Petitioner:

Appolo Colors, Inc.; Ault & Wiborg Group, Limited; Bagliani Inchiostri, S.p.A.; Bavaria Ketronic; Capitals SNL Insurance, Ltd.; Caribbean Inks, Ltd.; Casco Investors Corporation; Encres Dresse, S.A.; Fuchs & Lang-Sun Chemical de Venezuela, Ltd.; FyL Mexicana, S.A. de C.V.; General Printing Ink (Australia) Pty., Ltd.; General Printing Ink Corporation of Canada, Ltd.; Grasisk Farg; Inmobiliaria Sunchem, S.A. de C.V.; Juma International, Ltd.; Kollsman System-Technik, GmbH; Materiels-Equipement-Graphique; PHTHALCHEM, Inc.; Prism Printing Ink, Inc.; Quimica Flesch S.A. (Chile); St. John's Chemical Corporation, Inc.; Societe France Couleurs, S.A.; Sun Chemical de Centro America, S.A. de C.V.; Sun Chemical de Panama, S.A.; Sun Chemical Deutchland GMBH; Sun Chemical Limited; Sun Chemical (U.K.) Inc.; Sunchem Properties (Pty) Ltd.; Sun General Printing Ink S.A. (Pty) Ltd.; Swire General Printing Inks, Ltd.; Warwick Brackets Espanola, S.A.

In the

Supreme Court of the United States

OCTOBER TERM, 1982

SUN CHEMICAL CORPORATION, A Delaware Corporation, [Successor In Interest By Merger To Kollsman Instrument Corporation],

Petitioner,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

Sun Chemical Corporation ["Taxpayer"], as successor in interest by merger to Kollsman Instrument Corporation ["Kollsman"], petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals (App. A, *infra*, A1-A13) is reported officially below at 698 F.2d 1203 and, unofficially, at 83-1 USTC ¶ 9170 and at 51 AFTR2d ¶ 83-392.

The opinion of the Trial Division of the United States Court of Claims (App. G, *infra*, A18-A61) is not officially reported. It is reported unofficially at 82-1 USTC ¶ 9399 and at 50 AFTR2d ¶ 82-5047.

The 1978 opinion of the United States Court of Claims (App. B. *infra*, A14-A17) is officially reported at 218 Ct.Cl. 702 and, unofficially, at 78-2 USTC ¶ 9790 and at 42 AFTR2d ¶ 78-5308.

JURISDICTION

The judgment of the Court of Appeals (App. D, *infra*, A62) was entered on January 26, 1983. A timely filed Petition for Rehearing and Suggestion for Rehearing En Banc was denied by an order of the Court of Appeals dated February 28, 1983 (App. E, *infra*, A63). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

The constitutional provisions, statutes, and regulations involved are lengthy and are set forth in separate appendices. The constitutional provisions are set forth at Appendix F, *infra*, A64-A65; the provisions of the United States Code involved are set forth at Appendix G, *infra*, A66-A71, and the regulations provisions involved are set forth at Appendix H, *infra*, A72-A78.

The constitutional provisions involved are Article III, Sections 1 and 2, and the due Process Clause of the Fifth Amendment.

The United States Code provisions involved are Title 26 (Internal Revenue Code), Section 63 (Taxable income defined) and Section 172 (Net operating loss deduction); and also Title 28 (Judiciary and Judicial Procedure), Section 1255 (Court of Claims; certiorari; certified questions). 28 U.S.C. §1255 was repealed by Public Law 97-164, Title I, Section 123, April 2, 1982, *96 Stat. 36*, which had a generally effective date of October 1, 1982, *96 Stat. 57*.

The regulations provisions involved are those of § 1.172 (Net operating loss deduction, etc.), Title 26-Internal Revenue, 1954 Code of Federal Regulations.

STATEMENT OF THE CASE

The Petition in this case was filed in the United States Court of Claims, the court of first instance, on September 14, 1973. That court had jurisdiction of the action under Sections 1491 and 1346(a)(1) of Title 28 of the United States Code entitled "Judiciary and Judicial Procedure" (28 U.S.C. §§1491 and 1346(a)(1)). The Petition asserted a claim against the United States for the recovery of federal income taxes alleged therein to have been erroneously or illegally assessed or collected.

At page 49 of the Petition, Taxpayer demanded judgment against the United States for, *inter alia,* the following relief:

> "A. A finding by this Court that Kollsman should not have included in its 1963, 1964, or 1965 income any amounts whatever on account of any claim it might have had at the end of those years to receive amounts under Contract 10256 with the Air Force in excess of the fixed-price of $6,718,480 provided for in said Contract 10256.

One of the two claims for refund upon which this refund suit is based seeks a refund of $842,634.04 in Kollsman's 1961 income taxes by reason of an increased net operating loss for 1964 (App. J, *infra,* A80-A83). In part that claim reads as follows (App. J, *infra,* A80):

> "K. The claimant believes that this claim should be allowed for the following reasons:
>
> 1. There were [sic] erroneously included in the 1964 income of Kollsman Instrument Corporation ("Taxpayer") the amount of $1,708,000 for the following reasons: * * *"

For the year 1964, Kollsman had incurred a net loss of $913,506.18. (App. I, *infra,* A79). In the aforementioned claim for refund, it sought to increase that 1964 net operating loss by, *inter alia,* the aforementioned $1,708,000 and carry back that increased 1964 net operating loss to 1961. (App. J, *infra,* A83). That claim for refund was filed on May 13, 1968. (App. A, *infra,* A4).

On August 23, 1965, the Commissioner of Internal Revenue had mailed to Kollsman a "90-Day Letter" by which he determined a deficiency in Kollsman's income tax liability for 1961 of $185,387.67 (*Record*, Defendant's Exhibit 12). On November 19, 1965, Kollsman filed in the United States Tax Court a Petition by which it sought a redetermination of the aforementioned alleged deficiency in its 1961 income taxes; that case was docketed as *Kollsman Instrument Corporation* v. *Commissioner of Internal Revenue*, No. 6606-65. (*Record*, Defendant's Exhibit 13). On December 5, 1969, the Tax Court entered its final decision in that case by which it ordered and decided that there was a deficiency in Kollsman's 1961 income taxes of $185,610.47. (*Record*, Defendant's Exhibit 19).

On April 25, 1978, the United States filed a motion for partial summary judgment which, as relevant to this Petition, moved for summary judgment upon the portion of Taxpayer's cause of action which sought a refund on account of the alleged increased 1964 net operating loss and its carryback to 1961. That motion stated that Taxpayer "is not entitled to relitigate its tax liability for 1961, and the instant suit for refund for that year is barred by res judicata." (*Record*, Motion For Partial Summary Judgment, p. 3).

On July 27, 1978, Taxpayer filed its objections and response to the United States' motion for partial summary judgment which stated in part that "there has been no prior adjudication that the $1,708,000 which plaintiff included in its 1964 income for federal income tax purposes was properly so included." (*Record*, Plaintiff's Objections And Response To Defendant's Motion For Partial Summary Judgment, p. 4).

On November 3, 1978, the Court of Claims entered its order (App. B, *infra*, A14-A17) granting the United States' motion for partial summary judgment. In relevant part, that order read as follows (App. B, *infra*, A15-A16):

> "* * * Plaintiff contends that the Tax Court decision [in case no. 6605-65] does not bar it from litigating whether it had net operating losses for 1964 that could carry back to 1961, if that issue was not litigated or

> determined in the Tax Court. But the only reason plaintiff wishes to litigate its 1964 income is to use its asserted losses in that year to reduce its taxes for 1961, and the Tax Court decision put to rest all questions concerning plaintiff's liability for the latter year. The Tax Court decision 'bars further litigation not only on those aspects of the [1961] tax which were actually raised but also on the issues which could have been presented.' * * * Plaintiff could have raised in the Tax Court suit the issue it now seeks to litigate in this court, but failed to do so."

The Court of Claims did not, at that time or thereafter, enter judgment pursuant to that order.

After the Court of Claims had entered its order of November 3, 1978, the cause was remanded to the Trial Division of that court. On April 12, 1979, the United States amended its answer by adding thereto new paragraphs alleging the affirmative defense of estoppel; in part that amended answer read as follows (*Record*, Second Amended Answer, pp. 2-3):

> "64. On April 13, 1967, Kollsman filed a timely claim for refund for 1960, asserting a net operating loss carryback from 1963 which was based upon the asserted erroneous inclusion in 1963 of income with respect to Air Force Contract 10256.
>
> "65. During the audit consideration by the Internal Revenue Service of Kollsman's 1967 year, Kollsman agreed with the Internal Revenue Service to withdraw and not to prosecute its 1960 refund claim (referred to in paragraph 64, above) in consideration for the allowance of the related 1967 deduction with respect to the income from Air Force Contract 10256 which had been reported in 1963.
>
> "66. The 1967 deduction claimed by Kollsman Instrument Corporation, as referred to in paragraph 63, was allowed upon audit by the Internal Revenue Service, and the statute of limitations on further assessment was allowed to expire without further action by reason of the agreement referred to in paragraph 65, above.
>
> "67. Because of the facts set forth in paragraphs 63 through 66, above, plaintiff's claim in the instant action for

a net operating loss carryback from 1963 to 1960 is barred by estoppel."

Trial was held before Trial Judge Philip R. Miller on October 28, 29, and 30, 1980. (*Record*, Transcript, Volumes I, II, and III, pp. 1-565). After Taxpayer rested its case, the United States called as its witnesses Revenue Agent Harold Breitbart (*Transcript*, pp. 440-469), Revenue Agent Simon Markowitz (*Transcript*, pp. 471-509), Revenue Agent Joseph Petchesky (*Transcript*, pp. 509-538), and Case Manager Bernard H. Ryan (*Transcript*, pp. 539-556).

Trial Judge Miller filed his opinion, recommended decision, findings of fact, and conclusions of law (App. C, *infra*, A18-A61) on May 24, 1982. He recommended a decision holding that it was not necessary to reach the merits because:

> (1) The portion of Taxpayer's claim based upon an alleged 1963 net operating loss and its carryback to 1960 was barred because Taxpayer had not filed a sufficient claim for refund.
>
> (2) The portion of Taxpayer's claim based upon an alleged increased 1964 net operating loss and its carryback to 1961 had already been decided by the November 3, 1978, order of the Court of Claims which was correct but "* * * [i]n any event a trial judge of this court has no authority to reverse the decisions of its appellate division." (App. C, *infra*, A24).

On January 26, 1983, the Court of Appeals affirmed the Claims Court. (App. A, *infra*, A1-A13). It agreed that what it characterized as "[t]he 1960 Claim (via the 1963 carryback)" was not supported by a valid claim for refund (App. A, *infra*, A5-A12); and held that what it characterized as "[t]he 1961 Claim (via the 1964 carryback)" had already been decided by the November 3, 1978, order of the Court of Claims. The court held that "the Court of Claims dismissal of the 1961 claim is res judicata and thereby bars appellant from relitigating this issue on appeal to this court." (App. A, *infra*, A12-A13).

REASONS FOR GRANTING THE WRIT

I

The Court of Appeals Decision—Holding That Taxpayer's Formal Claim For Refund Which Was Based Upon An Alleged 1963 Net Operating Loss And Its Carryback To 1960 Is Insufficient To Support This Refund Suit—Conflicts With Applicable Decisions Of This Court

Taxpayer's Claim For Refund (App. L, *infra*, A87-A90), which was extensively considered on its merits and denied by revenue agents, is a formal claim which speaks for itself. Although it did suggest that deductions taken in 1966 with respect to Air Force Contract 10256—taken on the theory that Taxpayer had correctly included the amounts involved in its 1963 income in the first place—might have been "proper in the circumstances" (App. L, *infra*, A88), there is nothing in the claim itself which made it conditional or contingent on anything.

The Trial Judge held that Taxpayer's refund claim was inadequate to support this refund suit because (App. C, *infra*, A33):

> "* * * There was no occasion for the Service to make an administrative investigation of whether the inclusion of the sum in 1963 income was erroneous or a proper exercise of discretion under the taxpayer's method of accounting during that year, and the correct amount thereof. There was no opportunity for the service to determine administratively whether plaintiff's present contention is correct and, if so, to avoid litigation."

That basic premise of the Trial Judge's decision is dead wrong. As the Record shows, Taxpayer's refund claim *was* considered on its merits by the Internal Revenue Service (App. M, *infra*, A91-A97). The Examination Report attached to a "30-Day Letter" dated February 28, 1972, addressed to Kollsman rejected the claim on its merits (App. M, *infra*, A93, A96, A97):

"* * * This claim is being denied for the reasons stated beginning at page T34 entitled 'Reduction 1963-5 Claim Against U.S. Air Force Percentage Of Completion Method and item (d) schedule 10(a) of this report. Taxpayer has agreed to this adjustment. * * *"

"Under date of Dec. 4, 1967, Revenue Agent Harold Breitbart, who had examined the 1963 and 1964 returns and to whom the 1963 claim was assigned, replied with the requested information and an opinion that 'the income of the contract in question was properly included in the years 1963, 1964 and 1965 and the adjustment subsequently determined, is deductible in the year 1967 when the dispute was finalized.' This examiner concurs in that opinion, a copy of which is submitted with the workpapers, and so holds in this report in disallowing the claimed deduction of 4,359,000—for the year 1966."

"The above determination also results in a conclusion most favorable to the Government inasmuch as the adjustment or deduction takes place in the latest possible year thereby eliminating the substantial interest factor in a refund or allowance in an earlier year for so large an amount."

The requirements that refund claims formally and adequately set forth facts and grounds for recovery with particularity are "devised not as traps for the unwary, but for the convenience of government officials in passing upon claims for refund and in preparing for trial." *Tucker* v. *Alexander,* 275 U.S. 228, 231, 72 L.Ed. 253, 48 S.Ct. 45 (1927). As Mr. Justice Cardozo wrote for the Court in *United States* v. *Memphis Cotton Oil Co.,* 288 U.S. 62, 71, 77 L.Ed. 619, 53 S.Ct. 278 (1933):

> "The function of the statute, like that of limitations generally, is to give protection against stale demands. The function of the regulation is to facilitate research."

That case held that a seasonably-filed refund claim which failed to state the grounds for refund could—after expiration of the limitation period but before the claim had been finally rejected—amend the claim to conform to the specificity requirements. See also, *United States* v. *Factors & Finance Co.,* 288

U.S. 89, 96, 77 L.Ed. 633, 53 S.Ct. 287 (1933), where the Court also allowed a defective claim to be amended after the period of limitations because it had not yet been rejected by the Commissioner and "* * * [t]his question, if no other, he must have considered and determined when a claim for refund was submitted by the taxpayer without specifying the grounds. * * * The cumulative force of these administrative opportunities * * * upholds the claim and the amendment."

The Court of Appeals decision that Taxpayer's claim for refund was inadequate is contrary to and conflicts with applicable legal principles proclaimed by the Court in *United States* v. *Kales*, 314 U.S. 186, 86 L.Ed. 132, 62 S.Ct. 214 (1941). The procedural question presented was whether a letter written to the tax collector by a taxpayer was a sufficient claim for refund. That informal letter—like taxpayer's formal claim here—was by its terms based upon "alternatives." Mr. Chief Justice Stone for the Court held that the letter was indeed an adequate refund claim and wrote in part [314 U.S. at 195-197]:

> "The fact that respondent had originally stated her claim in the future tense, stating that in the event of departmental revision of the valuation of the stock she 'will insist' on a higher valuation and 'will claim the right to a refund,' does not in the circumstances of this case lend even grammatical support to the Government's contention. Such a use of the future tense in stating a claim may, with due regard to the circumstances of making it, rightly be taken as the assertion of a present right. * * * Here the claim is alternative and contingent upon future events. The statement that upon the happening of the contingency the claim will be prosecuted is not inconsistent with the present assertion of it. It is indeed an appropriate, if not the necessary phraseology for the present assertion of an alternative claim with respect to which a taxpayer in his presentation of an informal tax refund claim, should be in no less favorable position than the plaintiff in a suit at law who is permitted to plead his cause of action in the alternative. * * *
>
> "If the point were more doubtful than we think it is, it would be resolved by the consistent administrative treatment of respondent's letter * * *. Neither the original nor

> the amended claim has ever been rejected as inadequate by the Commissioner or the Bureau. There has been no objection to the claim on the ground that it was informal, deficient in its content, or untimely. * * * [T]he claim was held under advisement by the Bureau for nearly seven years. * * * [I]t was consistently treated in correspondence by the Bureau and at hearings during this period as a claim for refund. The Commissioner finally * * * declined to consider the claim on the sole ground that it was no longer a subject of administrative action * * *. Not only do we think that this entire course of departmental action was an administrative construction of respondent's letter * * * but we think it was a waiver of the requirements of the regulations as to the formality and particularity with which the grounds for refund are required to be stated. * * *"

The Internal Revenue Service, in the administrative proceedings which preceded this case, never rejected Taxpayer's claim as inadequate or even questioned its sufficiency. In addition, in this case, the United States did not plead any alleged deficiency in the refund claim nor did it include any asserted defect as a ground for its 1978 motion for partial summary judgment. If it had, of course, the proper motion would have been a motion for judgment, not merely a motion for partial judgment.

The Government did, however, allege the affirmative defense of estoppel (*Record,* Second Amended Answer) because of "understandings" (*Transcript,* pp. 482, 490, 518, 523, 544, 549) of the revenue agents that the claim would be withdrawn and not pursued. The Trial Judge made no finding or holding *re* that estoppel defense but did bolster his opinion that the refund claim was insufficient by referring to testimony of the revenue agents. (App. C, *infra,* A27-A31).

In effect, the Trial Judge and the Court of Appeals held that Taxpayer's refund claim had been compromised as a result of discussions between Taxpayer's employees and revenue agents. While there was no evidence introduced that *Taxpayer's* employees had authority to enter into any compromise

agreement, one thing is beyond dispute: Internal Revenue Service employees have no authority to enter into any compromise or closing agreements.

In *Botany Worsted Mills* v. *United States,* 278 U.S. 282, 73 L.Ed. 379, 49 S.Ct. 129 (1929), the Court held that a taxpayer was not estopped from procuring a tax refund by agreements which it had made with subordinate officials of the Bureau of Internal Revenue. Mr. Justice Sanford, writing for a unanimous Court (Mr. Justice Holmes agreeing with the result), rejected the Government's argument that the taxpayer was estopped by its prior agreements [278 U.S. at 288-289]:

> "We think that Congress intended by the statute to prescribe the exclusive method by which tax cases could be compromised, requiring therefor the concurrence of the Commissioner and the Secretary, and prescribing the formality with which, as a matter of public concern, it should be attested in the files of the Commissioner's office; and did not intend to entrust the final settlement of such matters to the informal action of subordinate officials in the Bureau. When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode."

Assuming *arguendo* that Taxpayer had indeed entered into a closing agreement or compromise of its tax case with one or more of the revenue agents who testified at the trial, the Government's case would fail for another basic reason. Garden variety Internal Revenue Service employees—such as revenue agents and group chiefs—have no authority to enter into agreements with taxpayer which compromise tax cases. *Baker* v. *Commissioner,* 24 T.C. 1021, 1024 (1955)(revenue agents); *Bennett* v. *United States,* 231 F.2d 465, 468 (7th Cir. 1956) (head of Chicago Division Technical Staff); *Wilkinson* v. *United States,* 157 Ct.Cl. 847, 859 (1962) (revenue agent); *Bornstein* v. *United States,* 170 Ct.Cl. 576, 579-583 (1965) (Conferee Reviewer); *Gardner* v. *Commissioner,* 75 T.C. 475, 478-479 (1980) (Appeals Officer); *Boulez* v. *Commissioner,* 76 T.C. 209, 211-215 (1981) (Director of International Operations).

II

The Court Of Appeals Decision—Holding That The 1978 Order Of The Court Of Claims Granting The Government's Motion For A Partial Summary Judgment Was A Final, Appealable Judgment Entitled To *Res Judicata* Effect—Is Contrary To Decisions Of This Court And Of The Other Court Of Appeals

That Decision Also Allows To Stand, Unreviewed, A Decision In Conflict With Decisions Of This Court And Contrary To The Controlling Statutory Provisions

2.1

The Court Of Appeals Decision That The 1978 Order Of The Court Of Claims Was A Final, Appealable Judgment, And Therefore Res Judicata *And Not Currently Reviewable, Conflicts With Applicable Decisions Of This Court And With Decisions Of The Other Court Of Appeals On The Same Issue.*

The order of the United States Court of Claims granting Respondent's motion for partial summary judgment (App. B, *infra,* A14-A17) was entered on November 3, 1978. The Court of Claims did not, either at that time or later, however, enter judgment pursuant to that order. The jurisdiction of this Court then to review that order would have been under 28 U.S.C. § 1255 (App. G, *infra,* A71), which was repealed by Public Law 97-164, Title I, Section 123, April 2, 1982, *96 Stat. 36;* that Act had a generally effective date of October 1, 1982, *96 Stat. 57.*

Until the Court of Claims entered its final judgment in the cause, it had plenary power to reconsider its order granting the Government's motion for partial summary judgment. *Marconi Wireless Telegraph Co.* v. *United States,* 320 U.S. 1, 47-48, 87 L.Ed. 1731, 63 S.Ct. 1393 (1943). The question there presented was whether the Court of Claims had power, until it entered a final decision in the cause, to reconsider an interlocutory

decision that a patent was valid and infringed. Unlike this case, the interlocutory decisions there had, by statute, specifically been made appealable.

From the beginning it has been a *sine qua non* of the law of procedure, and a fundamental principle of this Court, that review will be limited to final orders and judgments which dispose of the entire subject matter of a case and all causes of action involved. *Perkins* v. *Fourniquet,* 47 U.S. (6 How.) 206, 208, 12 L.Ed. 406 (1848); *American Construction Company* v. *Jacksonville, Tampa and Key West Railway Company,* 148 U.S. 372, 385-386, 37 L.Ed. 486, 13 S.Ct. 758 (1893); *Rexford* v. *Brunswick-Balke Collender Company,* 228 U.S. 339, 345-346, 57 L.Ed. 864, 33 S.Ct. 515 (1913); *Collins* v. *Miller,* 252 U.S. 364, 370-371, 64 L.Ed. 616, 40 S.Ct. 347 (1920); *Nyanza Steamship Company, Ltd.* v. *Jahncke Dry Dock No. 1,* 264 U.S. 439, 440, 68 L.Ed. 777, 44 S.Ct. 355 (1924); *Cobbledick* v. *United States,* 309 U.S. 323, 324-325, 84 L.Ed. 783, 60 S.Ct. 540 (1940); *Catlin* v. *United States,* 324 U.S. 229, 240, 89 L.Ed. 911, 65 S.Ct. 631 (1945); *Gardner* v. *Westinghouse Broadcasting Co.* 437 U.S. 478, 480-482, 57 L.Ed. 2d 364, 98 S.Ct. 2451 (1978); *Coopers & Lybrand* v. *Livesay,* 437 U.S. 463, 468-469, 57 L.Ed. 2d 351, 98 S.Ct. 2454 (1978); *Firestone Tire & Rubber Company* v. *Risjord,* 449 U.S. 368, 376, 66 L.Ed. 2d 571, 101 S.Ct. 669 (1981).

Liberty Mutual Insurance Co. v. *Wetzel,* 424 U.S. 737, 47 L.Ed. 2d 435, 96 S.Ct. 1202 (1976), held that an order granting a partial summary judgment was not reviewable as a final order because—although it held defendant was liable—it left unresolved the plaintiff's prayers for relief. The Court further held that the Rule 54(b) certification of the order was of no avail [424 U.S. at 745-746]:

> "Were we to sustain the procedure followed here, we would condone a practice whereby a district court in virtually any case before it might render an interlocutory decision on the question of liability of the defendant, and the defendant would thereupon be permitted to appeal without satisfying any of the requirements that Congress

> carefully set forth. We believe that Congress * * * has been well aware of the dangers of an overly rigid insistence upon a 'final decision' for appeal in every case, and has * * * made ample provision for appeal of orders which are not 'final' so as to alleviate any possible hardship. We would twist the fabric of the statute more than it will bear if we were to agree that the District Court's order * * * was appealable to the Court of Appeals."

From the beginning of modern practice, and currently, Courts of Appeals for the other circuits have held partial summary judgment orders not to be immediately reviewable. The decision of the Court of Appeals in this case conflicts absolutely with decisions such as: *Leonard* v. *Socony-Vacuum Oil Co.*, 130 F.2d 535, 536 (7th Cir. 1942); *Audi Vision Inc.* v. *RCA Mfg. Co., Inc.*, 136 F.2d 621, 624-625 (2d Cir. 1943); *Coffman* v. *Federal Laboratories, Inc.*, 171 F.2d 94, 96-97 (3d Cir. 1948); *Borges* v. *Art Steel Co.*, 243 F.2d 350 (2d Cir. 1957) ("Judge Dimock's citation demonstrates what the facts disclose, namely, that this is but a 'partial summary judgment' which, under well settled rules, is not appealable"); *Backus Plywood Corp.* v. *Commercial Decal Inc.*, 317 F.2d 339, 341 (2d Cir. 1963); *Gabbard* v. *Rose*, 330 F.2d 705, 706 (6th Cir. 1964); *Cohen* v. *Curtis Publishing Company*, 333 F.2d 974, 978 (8th Cir. 1964); *Travelers Indemnity Company* v. *Erickson's Inc.*, 396 F.2d 134, 135-136 (5th Cir. 1968); *United Bonding Insurance Company* v. *Stein*, 410 F.2d 483, 485 (3d Cir. 1969); *United States* v. *Desert Gold Mining Co.*, 433 F.2d 713, 715 (9th Cir. 1970); *Levin* v. *Baum*, 513 F.2d 92, 96 (7th Cir. 1975); *TMA Fund* v. *Biever*, 520 F.2d 639, 641 (3d Cir. 1975); *Allis-Chalmers Corporation* v. *Philadelphia Electric Company*, 521 F.2d 360, 365 (3rd Cir. 1975); *Stewart Title & Trust of Phoenix* v. *Ordean*, 528 F.2d 894, 897 (9th Cir. 1976); *Dilly* v. *S.S. Kresge*, 606 F.2d 62, 63 (4th Cir. 1979); *Chacon* v. *Babcock*, 640 F.2d 221, 222 (9th Cir. 1981); *Pettinelli* v. *Danzig*, 644 F.2d 1160, 1162 (5th Cir. 1981); *Calmaquip Engineering West Hemisphere Corporation* v. *West Coast Carriers, Ltd.*, 650 F.2d 633, 635-636 (5th Cir. 1981); *Winfield* v. *St. Joe Paper*

Company, 663 F.2d 1031, 1032 (11th Cir. 1981); *Freeman* v. *Kohl & Vick Machine Works, Inc.*, 673 F.2d 196, 199 (7th Cir. 1982); *Yeager* v. *Drug Enforcement Administration*, 678 F.2d 315, 319 (D.C. Cir. 1982); *Mullins* v. *Nickel Plate Mining Co., Inc.*, 691 F.2d 971, 972-973 (11th Cir. 1982); *Wheeler Machinery Company* v. *Mountain States Mineral Enterprises, Inc.*, 696 F.2d 787, 789 (10th Cir. 1983).

The principle upon which such cases are based is of no slight consequence; as Judge Sneed wrote in *Curlott* v. *Campbell*, 598 F.2d 1175, 1179 (9th Cir. 1979)—which held that a partial summary judgment granted by the trial court on less than all of the issues in the case was not appealable, hence had no *res judicata* effect—: "The final judgment rule is 'the dominant rule in federal appellate practice.' "

Like any other interlocutory order, of course, a particular partial summary judgment order could be immediately reviewable if it qualifies under the collateral order exception to the finality rule. See *Chavez* v. *Singer*, 698 F.2d 420, 421 (10th Cir. 1983), where the partial summary judgment denied a federal employee's absolute immunity defense. Even though a partial summary judgment order might fall within that exception, however, it would also be reviewable at the time of final judgment. *United States* v. *United States Smelting Refining & Mining Co.*, 339 U.S. 186, 198-199, 94 L.Ed. 750, 70 S.Ct. 537 (1950).

To justify its decision in this case that the 1978 order of the Court of Claims was *res judicata* and not subject to current review, the Court of Appeals asserted that the "* * * court's dismissal of the 1961 [sic] claim * * * operated as an adjudication upon the merits, Court of Claims Rule 102(b)(3), and as a final judgment * * *." (App. A, *infra*, A12). That rule read in relevant part as follows:

Rule 102. Dismissal of Actions

. . . (a) Voluntary Dismissal; Effect Thereof.

* * *

(b) Involuntary Dismissal: Effect Thereof.

(1) Upon its own motion, the court may dismiss any action at any time.

(2) For failure of the plaintiff to prosecute the action or to comply with these rules or with any order of the court, the defendant may move that the court dismiss the action. (Cf. Rules 76, 92, and 114.)

(3) Unless the court in its order for dismissal otherwise specifies, a dismissal under paragraphs (b), (c), or (d) of this rule, and any dismissal not provided for in this rule (other than a dismissal for lack of jurisdiction), operates as an adjudication upon the merits.

(c) Insufficiency of Evidence.

* * *

(d) Effect of Counterclaim

* * *

It would appear that the Court of Appeals has misread and misapplied that rule; by its terms, it applies only to dismissals of "actions," not to orders granting partial summary judgments. Even if the Court of Appeals correctly applied that rule to this case, however, its decision that the 1978 order was *res judicata* would nonetheless conflict with the applicable decisions of this Court.

Any internal rule of the Court of Claims declaring an order granting a motion for a partial summary judgment to have been "on the merits" would have been nothing more than a declaration by that court that the order would be considered to be the "law of the case." *Coastal Petroleum Company* v. *U.S.S. Agri-Chemicals*, 695 F.2d 1314, 1319 (11th Cir. 1983). Even if that declaration had been sufficient to have transmuted the 1978 order into a reviewable order, it would not have prevented a review of that order now. *United States* v. *United States Smelting Refining & Mining Co.*, 339 U.S. 186, 94 L.Ed. 750, 70

S. Ct. 537 (1950). Not even the fact that the order under scrutiny had granted a temporary injunction estopped the appellant there from challenging it when the cause was concluded [339 U.S. at 198-199]:

> "* * * The fact that an appeal could have been taken from the first order of the District Court was not because it was a final adjudication but because a temporary injunction had been granted in order to maintain the status quo. This was an interlocutory order that was appealable because Congress, notwithstanding its interlocutory character, had made it appealable. * * * The appellants might have appealed, but they were not bound to. We think that it requires a final judgment to sustain the application of the rule of the law of the case just as it does for the kindred rule of *res judicata.* * * *"

See also, *Hamilton-Brown Shoe Co.* v. *Wolf Brothers & Co.*, 240 U.S. 251, 257-258, 60 L.Ed. 629, 36 S.Ct. 269 (1916), which rejected the proposition that a prior, unsuccessful attempt at Supreme Court review of an interlocutory decree, which admittedly established the "law of the case" in the lower courts, precluded review at the time of final decision of the case.

2.2

The 1978 Order of the Court Of Claims, Deciding That The Tax Court's Redetermination Of A Deficiency In Taxpayer's 1961 Income Taxes Is Res Judicata *Of Taxpayer's 1964 Net Operating Loss Claim In This Case, Not Only Conflicts With Applicable Decisions Of This Court But Also Disregards The Statutory Provisions Establishing The Law Of Net Operating Losses.*

The Court of Claims' 1978 order (App. B, *infra*, A14-A17) held that the Tax Court judgment in Case No. 6605-65 was *res judicata* of Taxpayer's present refund claim because those issues in this case "could have been presented" in that prior litigation. (App. B, *infra*, A16). The *sine qua non* of that order is the following syllogism:

> All judicial decisions which determine deficiencies in income taxes for a particular tax year are *res judicata* of any question concerning an increase or decrease of income tax liability for that year.
>
> All Tax Court decisions are judicial decisions which determine deficiencies in income taxes for a particular tax year.
>
> Therefore, all Tax Court decisions are *res judicata* of any question concerning an increase or decrease of income tax liability for that year.

Neither premise is correct and each overlooks the law, *to wit:* (1) Controlling, inconsistent decisions of this Court; and (2) Statutory provisions enacted by Congress on the subject of net operating losses (*e.g.*, Kollsman's 1964 year) and net operating loss deductions (*e.g.*, Kollsman's 1961 year). (App. G, *infra*, A66-A71).

2.2.1

Res judicata claim preclusion is not applicable if the cause of action in a current case is different from the cause of action which was judicially decided in a prior case; and the cause of action upon which Taxpayer's 1964 net operating loss claim is based in this case is not the same as the cause of action which was decided by the Tax Court in redetermining Kollsman's 1961 income tax deficiency.

Cromwell v. *County of Sac*, 94 U.S. 351, 352-353, 24 L.Ed. 195 (1877), refused to apply *res judicata* where the second action was upon a claim or cause of action which was different from the claim or cause of action at issue in the prior action; the Court declared that "* * * [i]n all cases, therefore, where it is sought to apply the estoppel of a judgment rendered upon one cause of action to matters arising in a suit upon a different cause of action, the inquiry must always be as to the point or question actually litigated and determined in the original action, not what might have been thus litigated and determined."

Commissioner v. *Sunnen*, 333 U.S. 591, 598-599, 92 L.Ed. 898, 68 S.Ct. 715 (1948), held that neither *res judicata* nor collateral estoppel made conclusive a prior Tax Court judgment because " * * * if the later proceeding is concerned with a similar or unlike claim relating to a different tax year, the prior judgment acts as a collateral estoppel only as to those matters in the second proceeding which were actually presented and determined in the first suit."

United States v. *International Building Co.*, 345 U.S. 502, 97 L.Ed. 1182, 73 S.Ct. 807 (1953), reversed a decision of the Eighth Circuit which had held that a prior Tax Court decision was *res judicata* in a subsequent refund case. The Prior Tax Court decision there—like the one involved here (*Record*, Defendant's Exhibit 19)—was entered pursuant to a stipulation of the parties, without a hearing, and redetermined alleged deficiencies in income taxes for a prior year. This Court refused to give any estoppel-by-judgment effect to the prior Tax Court decision [345 U.S. at 505-506]:

> "We conclude that the decisions entered by the Tax Court * * * were only a *pro forma* acceptance by the Tax Court of an agreement between the parties to settle their controversies for reasons undisclosed. There is no showing either in the record or by extrinsic evidence * * * that the issues raised by the pleadings were submitted to the Tax Court for determination or determined by that court. They may or may not have been agreed upon by the parties. * * * As the case reaches us, we are unable to tell whether the agreement of the parties was based on the merits or on some collateral consideration. Certainly the judgments entered are *res judicata* of the tax claimed for the years 1933, 1938 and 1939, whether or not the basis of the agreements on which they rest reached the merits. But unless we can say they were an adjudication of the merits, the doctrine of estoppel by judgment would serve an unjust cause: it would become a device by which a decision not shown to be on the merits would forever foreclose inquiry into the merits. Estoppel by judgment includes matters in a second proceeding which were actually presented and determined in an earlier suit. * * * A judgment entered

> into with the consent of the parties may involve a determination of questions of fact and law by the court. But unless a showing is made that that was the case, the judgment has no greater dignity, so far as collateral estoppel is concerned, than any judgment entered only as a compromise of the parties."

The appropriate inquiry, therefore, is whether the cause of action which seeks a judicial decision here as to whether Kollsman incurred an increased net operating loss in 1964 is the same cause of action which was at issue in the 1961 Tax Court case. If the causes of action are not the same, the answer —beyond dispute—is "No!" *Missouri-Kansas Pipe Line Co.* v. *United States*, 312 U.S. 502, 508, 85 L.Ed. 975, 61 S.Ct. 666 (1941); *Lawlor* v. *National Screen Service Corporation*, 349 U.S. 322, 327, 99 L.Ed. 1122, 75 S.Ct. 865 (1955).

> "Whether a subsequent action is barred by the doctrine of *res judicata* depends on whether or not the inquiry in the first action was into the same factual situation creating the same substantive right as a matter of substantive law. * * *" Gavit, *The Code Cause of Action: Joinder and Counterclaims*, 30 Colum. L. Rev. 802, 836 (1930).

Plaintiff incurred a net operating loss in 1964 if its allowable deductions for that year exceeded its gross income for that year. *I.R.C.* § *172(c)* (App. G, *infra*, A70). Plaintiff earned taxable income in 1961 if its gross income for that year exceeded its allowable deductions for that year. *I.R.C.* § *63* (App. G, *infra*, A66). A "net operating loss deduction" is the "aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year." *I.R.C.* § *172(a)* (App. G, *infra*, A66). The law applicable to the determination of whether Kollsman incurred a net operating loss in 1964 is 1964 law. *Reg.* § *1.172-1(e)(1)(ii)* (App. H, *infra*, A73). The law applicable to the determination of the amount of Kollsman's 1961 taxable income, however, is 1961 law. *I.R.C.* § *172(e)* (App. G, *infra*, A71); *Reg.* § *1.172-1(e)(1)(iii)* (App. H, *infra*, A74); *Reo Motors, Inc.* v. *Commissioner of Internal Revenue*, 338 U.S. 442, 449, 450, 94

L.Ed. 245, 70 S.Ct. 283 (1950); *Lewyt Corporation* v. *Commissioner of Internal Revenue*, 349 U.S. 237, 242, 99 L.Ed. 1029, 75 S.Ct. 736 (1955).

In a case involving a net operating loss and a net operating loss carryback to a prior year, it is essential to distinguish between the transactions which take place in the year of the net operating loss and the transactions which occurred in the year to which that loss will be carried back. Because those transactions are by definition different, and will require different factual proofs, different claims or causes of action arise from each year: (1) the year of the net operating loss; and (2) the prior year to which the loss is carried. That being so, net operating loss carryback cases are concerned with collateral estoppel/issue preclusion rather than with *res judicata*/claim preclusion. This is because " 'Claim,' in the context of res judicata, has never been broader than the transaction to which it related." *I Restatement, Second, Judgments* §*24*, at 196.

Yet another defect lurks in the 1978 order of the Court of Claims: it attributes to Congress an absurd legislative intent. For example, Sections 172(b)(1)(F) and 172(b)(1)(G) of the Internal Revenue Code provide that net operating losses for taxable years after 1975 and 1969, respectively, shall be net operating loss carrybacks to each of the 10 taxable years preceding the year of the loss. (App. G, *infra*, A68). Any taxpayer which might qualify for a 10 year net operating loss carryback, therefore, would find it necessary to keep a Tax Court case pending for at least eleven years after the close of the prior year to which a loss might be carried back. Since a Tax Court case must normally be filed no later than three and one-half years after the close of a taxable year, *I.R.C.* §§*6072, 6213(a)*, and *6501(a)*, such taxpayers would find it necessary to keep Tax Court cases open for at least seven and one-half years after they are filed plus the additional time taken to procure a final judicial decision on the merits of the net operating loss claim.

2.2.2

The second and distinct reason why the Tax Court decision redetermining Kollsman's 1961 deficiency is not *res judicata* of the 1964 net operating loss issue in this case flows from the limited jurisdiction of the Tax Court. Even if the Tax Court *had* determined an overpayment, because of the increased 1964 net operating loss, that determination would not have constituted the "judicial act" which is the essential prerequisite to *res judicata.*

The Tax Court's jurisdiction is limited to (1) redeterminations of tax deficiencies and (2) determinations of overpayments for any years under deficiency scrutiny. The redetermination of any deficiency is enforceable, constitutes a judicial act, and has a conclusive *res judicata* effect. The determination of an overpayment is not legally enforceable, however, hence is not a judicial act at all and has (at most) only a collateral estoppel effect.

Since the Tax Court has no jurisdiction to order the refund of any determined overpayment, its decisions are *res judicata* only as to the questions involved in the computations and assessments of taxes for which deficiencies are claimed. *United States* ex rel *Girard Trust Co.* v. *Helvering,* 301 U.S. 540, 542-543, 81 L.Ed. 1272, 57 S.Ct. 855 (1937); *Commissioner of Internal Revenue* v. *Gooch Milling & Elevator Co.,* 320 U.S. 418, 420-421, 88 L.Ed. 139, 64 S.Ct. 184 (1943); *Morse* v. *United States,* 494 F.2d 876, 879-880 (9th Cir. 1974). Even if multiple tax years are properly before the Tax Court for redeterminations of income tax deficiencies, the Tax Court has no jurisdiction to determine an overpayment for one or more of those years and apply it against a deficiency or deficiencies redetermined for the other tax year or years. *First Security Bank of Idaho* v. *Commissioner of Internal Revenue,* 592 F.2d 1046 (9th Cir. 1979).

Quite simply, the Tax Court has no *judicial* jurisdiction to determine that there has been an overpayment of tax. As this Court noted in *United States* v. *O'Grady*, 89 U.S. (22 Wall.) 641, 648, 22 L.Ed. 772 (1874):

> "* * * [I]t is clear that when such a claim as that preferred by the claimants * * * passes into judgment in a court of competent jurisdiction it ceases to be open * * * to revision by any one of the executive departments or of all such departments combined. * * *"

In re Sanborn, 148 U.S. 222, 37 L.Ed. 429, 13 S.Ct. 577 (1893), held that no appeal would lie to the Supreme Court from an advisory opinion—given at the behest of an Executive Department but not obligatory upon it—of the Court of Claims [148 U.S. at 226-227]:

> "* * * We regard the function of the Court of Claims, in such a case, as ancillary and advisory only. The finding or conclusion reached by that court is not enforceable by any process of execution issuing from the court, nor is it made, by the statute, the final and indisputable basis of action either by the department or by Congress. * * *
>
> * * *
>
> "In the case before us there was * * * no final judgment obligatory upon the Department of the Interior, or enforceable by execution from any court. * * *"

One of the questions presented by *Pope* v. *United States*, 323 U.S. 1, 89 L.Ed. 3, 65 S.Ct. 16 (1944), was whether Supreme Court review of decisions of the Court of Claims was precluded by the fact that Congress had also imposed non-judicial functions of an administrative or legislative character upon that court. Mr. Chief Justice Stone for the Court answered "no" [323 U.S. at 12-13]:

> "* * * In all these cases [where courts exercise judicial functions] the court determines that the unchallenged facts shown of record establish a legally binding obligation; it adjudicates the plaintiff's right of recovery and the extent of it, both of which are essential elements of the judgment.

> "* * * It is true that Congress has imposed * * * non-judicial duties of an administrative or legislative character. *** Its decisions rendered in its administrative capacity are not judicial acts, and their review, even though sanctioned by Congress, is not within the appellate jurisdiction of this Court. * * * But notwithstanding the retention of such administrative duties * * *, Congress has provided for appellate review of the judgments of both courts rendered in their judicial capacity. * * *"

III

The Decision Of The Court Of Appeals And Also The 1978 Order Of The Court Of Claims Which, Together, Have Frustrated Taxpayer's Attempts To Procure A Decision On The Merits Of Its Claim Have Deprived Taxpayer Of Basic Fifth Amendment Procedural Due Process Rights Which Are Of Paramount Public Importance

In *Brinkerhoff-Faris Trust & Savings Co.* v. *Hill*, 281 U.S. 673, 74 L.Ed. 1107, 50 S.Ct. 451 (1930), Mr. Justice Brandeis for the Court wrote [281 U.S. at 681]:

> "But our decision in the case at bar is not based on the ground that there has been a retrospective denial of the existence of any right or a retroactive change in the law of remedies. We are not now concerned with the rights of the plaintiff on the merits * * *. Our present concern is solely with the question whether the plaintiff has been accorded due process in the primary sense—whether it has had an opportunity to present its case and to be heard in its support. * * *"

This case, of course, is based upon a cause of action which is different from the cause of action which has already been decided by the Tax Court. The overriding significance of this case to American taxpayers, however, is well illustrated by the recent case of *Russell* v. *Commissioner of Internal Revenue*, 678 F.2d 782 (9th Cir. 1982). The *Russell* case also involved an over-nine-year attempt by a taxpayer to get a judicial hearing on the merits of an alleged overpayment of tax [678 F.2d at 783]:

"PROCEDURAL HISTORY"

"This appeal arises from the pitfalls for the unwary created by the jurisdictional rules governing refund suits and tax deficiency contests in the district and tax courts. Russell has diligently pursued her refund claim through nine years of litigation but has not yet received a hearing on the merits in a court of competent jurisdiction.

"Russell's litigation odyssey began in 1973 * * *."

In 1974 the Tax Court had held that the Commissioner's Notice of Deficiency for 1965 was untimely; but the Tax Court in that prior case had refused to address the issue of whether Russell had in fact made an overpayment of her 1965 tax liability. The Ninth Circuit rejected the Government's argument that the Tax Court had already decided the question of taxpayer's correct 1965 tax liability and that taxpayer was estopped from questioning that judgment [678 F.2d at 786-787]:

"Russell's 1965 tax liability—both the deficiency and refund issues—was a single cause of action. * * * The Tax Court's 1974 decision that there was no deficiency, however, was not the sort of final and complete judgment that warrants the application of the doctrine of merger. The ruling dealt only with the untimely notice of deficiency and did not address the refund claim. It was only a partial resolution of the issues then pending before the Tax Court. * * * The decision that there was no deficiency was an interim ruling on only one aspect of that liability. The other aspect, that of the refund claim, was never ruled upon.

* * *

"The Governments' argument that Russell bypassed her opportunity to litigate her refund claim in the Tax Court ignores the posture of the proceedings below. Russell did raise the refund claim in the Tax Court by her motion for dismissal without prejudice. It was the Tax Court, not Russell, that failed to address all the issues.

> * * * [T]he decision that the deficiency assessment against Russell was time-barred did not require consideration of the amount of her 1965 tax liability.
>
> "* * * Neither *res judicata* nor the doctrine of law of the case prevent Russell from receiving an initial hearing in the Tax Court on the merits of her claim."

Albeit that but a single cause of action was involved in *Russell*—with the consequence that the particular injustice there did not approach Taxpayer's here—the importance of the deprivations of procedural due process nonetheless warranted judicial intervention there. The Ninth Circuit responded. One hopes this Court will do no less and that the next step on Taxpayer's "litigation odyssey" will be a full review by this Court.

IV

CONCLUSION

In addition to the usual reasons for review by this court —particular lower court decisions which conflict with decisions of this Court and of the other courts of appeals—a special and important reason to review this case is the nature of the procedural due process questions presented. Plenary review

would establish jurisdictional rules for Tax Court cases and refund suits; declare fundamental principles of estoppel by judgment for income tax cases; and assure American taxpayers that procedural due process for them is indeed alive and well and living in full vigor.

The Petition For A Writ Of Certiorari should be granted.

Respectfully Submitted,

PAUL A. TESCHNER
39 South LaSalle Street
Chicago, Illinois 60603
(312) 332-0346
Counsel For Petitioner

Of Counsel:
TESCHNER PROFESSIONAL CORPORATION
39 South LaSalle Street
Chicago, Illinois 60603

25 May 1983

APPENDICES

APPENDIX A

OPINION OF THE UNITED STATES COURT OF APPEALS

Entered: January 26, 1983

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

SUN CHEMICAL CORP.,
a Delaware corporation,
Appellant,

v.

THE UNITED STATES,
Appellee.

Appeal No. 341-73

DECIDED: January 26, 1983

Paul A. Teschner argued for appellant. With him on the brief was the *Teschner Professional Corporation.*

Abraham Gutwein argued for appellee. With him on the brief were Assistant Attorney General *Glenn L. Archer, Jr., Theodore D. Peyser, Robert S. Watkins,* and *Kenneth R. Boiarsky.*

Before MARKEY, *Chief Judge,* COWEN, *Senior Circuit Judge,* and BENNETT, *Circuit Judge.*

BENNETT, *Circuit Judge.*

Appellant (taxpayer) seeks a refund of taxes paid for the tax years 1960 and 1961 by reason of alleged net operating loss carrybacks from 1963 and 1964, respectively. The United

States Claims Court[1] held that (1) the 1960 claim (via the 1963 carryback) was barred by appellant's failure to file a sufficient administrative claim for refund, as required by section 7422(a) of the Internal Revenue Code[2] and Treasury Regulation § 301.6402-2(b)(1) (1963); and (2) the 1961 claim (via the 1964 carryback) was barred by the United States Court of Claims grant of partial summary judgment in favor of the government. We *affirm*.

Facts

In November 1962 appellant entered into a letter contract with the United States Air Force to engineer, design, and fabricate operational prototypes of a geodetic and photo mapping system and a ground data processing subsystem.[3] The letter contract was superseded by a formal, negotiated contract in April 1963, which was followed by a production contract in March 1964. The formal contract was for a fixed sum of $6,718,480, but was subject to the standard "Changes" clause.[4]

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[1] Pursuant to an order of this court dated October 4, 1982, Judge Miller on October 8, 1982, entered final judgment in accordance with his opinion of May 24, 1982.

[2] All section numbers refer to the Internal Revenue Code of 1954, as amended, title 26 of the United States Code, unless otherwise stated.

[3] At this time the taxpayer was Kollsman Instrument Corporation. Sun Chemical is the successor in interest by merger.

[4] The "Changes" clause reads, in pertinent part, as follows:

> "The Contracting Officer may at any time, by a written order, and without notice to the sureties, make changes, within the general scope of this contract, in any one or more of the following: (i) Drawings, designs, or specifications, where the supplies to be furnished are to be specially manufactured for the Government in accordance therewith; (ii) method of shipment or packing; and (iii) place of delivery. If any such change causes an increase or decrease in the cost of, or the work required for, the performance of any part of the work under this contract, whether changed or not changed by any such order, an equitable adjustment shall be made in the contract price or delivery schedule, or both, and the contract shall be modified in writing accordingly."

In the course of performance of the contract, numerous changes were incorporated into it. On December 30, 1964, appellant requested from the contracting officer an equitable adjustment of $5,528,205 (as revised on June 30, 1965) as a result of these changes. On January 10, 1966, the contracting officer issued his final decision allowing appellant only an additional $123,780. Appellant appealed to the Armed Services Board of Contract Appeals and, on September 26, 1967, the parties agreed to a total increase in the contract price of $2,000,000 in lieu of the $123,780.

In the meantime, appellant had to file income tax returns for the years of performance of the contract. Appellant chose to compute its contract income for 1963 through 1965 by the percentage of completion method, one of the methods of reporting income from long-term contracts, authorized by Treasury Regulation § 1.451-3 (1957). Basically, appellant used its total estimated income from the contract, rather than the specified contract amount, in reporting its income for these years. For the three tax years 1963 through 1965 appellant included an aggregate of $10,142,787 in gross income attributable to the Air Force contract. When the contracting officer issued his final decision, appellant determined that the "income" reported from the contract actually resulted in a loss. As a consequence, appellant determined it had a $4,359,000 loss on the contract and deducted this amount on its 1966 return.

The period of limitations for filing a claim for refund for 1963 was due to expire on June 30, 1967 (as extended by agreement). On April 13, 1967, appellant filed a claim for refund of its 1960 taxes, such refund resulting from the alleged net operating loss in 1963.

As mentioned earlier, in 1967 the parties reached a settlement for a $2,000,000 increase in the contract price. This necessitated a further recomputation of the loss on the contract. As a result, appellant deducted $3,318,000 on its 1967 tax return in lieu of the $4,359,000 loss reported on its 1966 return.

On May 13, 1968, appellant filed a claim for refund of its 1961 taxes based upon an asserted net operating loss carryback from 1964. No claim for refund was ever filed for an asserted overinclusion of income for 1965.[5]

The Internal Revenue Service (I.R.S. or Service) never sent statutory notices of disallowance for the 1960 and 1961 claims.[6] Instead, the I.R.S. allowed the appellant's $3,318,000 deduction on its 1967 return on audit without adjustment. The trial judge found, however, that this present suit for refund seeks to utilize the same losses as formed part of the basis for the deduction reported, and allowed, on the 1967 return.[7] The

---

[5] On appeal to this court, appellant has conceded that it is not entitled to any refund on either a loss from 1965 or a carryback from that year. In an earlier proceeding, the United States Court of Claims held that appellant's 1965 claim was barred because it did not file a timely claim for refund. *Sun Chemical Corp.* v. *United States*, 218 Ct. Cl. 702 (1978).

[6] The I.R.S. did, however, deny the 1960 claim (via the 1963 carryback). On February 28, 1972, the Service sent appellant a "30-day letter" containing a copy of the audit examination report. The report reads, in pertinent part, as follows:

"Year Ended 12/31/63

"(C) Claim Denied in Part (1,150,000)

"In a timely claim filed on April 13, 1967 containing two issues taxpayer asserted in *** the larger issue that 1,150,000 of income accrued on the books and included in the tax return for the year 1963, applicable to the development of Geodetic and Photo Mapping system, was reported as taxable income on the percentage of completion method in error. This claim is denied with respect to this issue inasmuch as it is held that the income was properly included in the year 1963 under Section 451 of the Internal Revenue Code of 1954 and the regulations thereunder. Taxpayer agrees to this adjustment."

The report later states, in effect, that the $3,318,000 deduction claimed in the 1967 return is allowed without adjustment.

[7] Appellant has not denied that the refund claims before the court involve part of the amount which constituted the 1967 deduc-

(Footnote continued on following page)

period for assessment of a deficiency for appellant's 1967 tax year expired on September 30, 1972 (as extended by agreement). Appellant filed its original petition in the United States Court of Claims on September 14, 1973.

The 1960 Claim (via the 1963 Carryback)

The Claims Court held that the 1960 claim (via the 1963 carryback) was barred because appellant had not filed a sufficient claim for refund. In essence, the trial judge found that the formal claim filed and the surrounding circumstances indicated that the claim was contingent upon the disallowance of the later (1967) deduction for the contract losses, and since this event did not occur, the claim did not adequately apprise the I.R.S. of the grounds for refund.

Section 7422(a) provides that no suit for the refund of taxes shall be maintained until a claim for refund has been duly filed with the Secretary of the Treasury according to the regulations established pursuant to law. Treasury Regulation § 301.6402-2(b)(1), promulgated under the above statutory authority, provides that the claim must "set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof," and that no refund will be allowed "except upon one or more of the grounds set forth in the claim." It is a well-established rule that a timely, sufficient claim for refund is a jurisdictional prerequisite to a refund suit. *See, e.g., United States* v. *Felt & Tarrant Co.*, 283 U.S. 269, 272 (1931); *Armstrong* v. *United States*, 681 F.2d 774, 775 (Ct. Cl. 1982);

(Footnote continued from preceding page)

tion. Rather, appellant seeks to differentiate between the treatment of the contract income claims and the 1967 deduction by characterizing the former as an "overinclusion-in-income" and the latter as a "deduction." Our holding in this case, however, does not turn upon the fact that appellant might enjoy a double benefit from the contract losses.

National Newark & Essex Bank v. *United States*, 410 F.2d 789, 792 (Ct. Cl. 1969).

The most important factor to be considered concerning the sufficiency of the 1960 claim is the wording of the formal refund claim filed by appellant. It states:

> There was erroneously included in the 1963 income of Kollsman Instrument Corporation ("Taxpayer") the amount of 1,150,000 for the following reasons:
>
> During the years 1963, 1964, and 1965, Taxpayer was performing services for the United States Air Force in the development of AN/USQ-28 Geodetic and Photo Mapping System. As a result of those services, the Taxpayer recorded upon its books of account amounts attributable to the performance of said services during those years as follows:

Year	Amount of Claim
1963	$1,179,326
1964	1,750,497
1965	1,537,520
	$4,467,343

> As a result, at the opening of business on January 1, 1966, Accounts Receivable of Taxpayer included the aforementioned amount of $4,467,343 which Taxpayer had included among its assets in the belief that all of the events had occurred which fixed the right of the Taxpayer to receive income from those services and in the further belief that the amount of that claim could be determined with reasonable accuracy.
>
> During 1966, the Taxpayer attempted to procure from the United States Air Force an admission affirming that it did in fact owe the Taxpayer the amount so recorded on its books of account; but this attempt was unsuccessful when on January 10, 1966 a determination was made by the Contracting Officer that Taxpayer only had a right to receive the amount of $108,343 instead of the aforementioned amount of $4,467,343 which was determined as follows:

Year	Applicable To Claim	Determined to Be Allowed	Balance
1963	$1,179,326	$29,326	$1,150,000
1964	1,750,497	42,497	1,708,000
1965	1,537,520	36,520	1,501,000

Accordingly, *in computing its taxable income for 1966, the Taxpayer eliminated from its assets the amount of $4,359,000 and charged off the claim which it had recorded against the United States Air Force.* The amount of $4,359,000 was the adjusted basis of said portion of the claim as determined by the application of Section 1011 of the Internal Revenue Code of 1954.

Although the *Taxpayer believes that the aforementioned treatment is proper in the circumstances, it also recognizes the alternative possibility* that the following provisions of Reg. Sec. 1.451-1(a) might apply:

> "* * * (I)f, in case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. * * * (I)f a Taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom." * * *

This claim for refund is filed in an attempt to comply with the above Regulation Provision and *is predicated upon the possibility that the $1,150,000 which Taxpayer included among its assets on account of the aforementioned claim in the year 1963 should not have been so included but rather should have reduced the 1963 taxable income of the Taxpayer.* (Emphasis added.)

At the outset, it should be noted that the above claim is sufficiently detailed to apprise the I.R.S. of the factual basis for the claim before it. The "claim," however, is ambiguous at best and occasionally contradictory—*e.g.*, the statement that "the

> Taxpayer believes that the aforementioned treatment [whereby appellant overstated income in 1963 through 1965 and deducted this amount in a later year] is proper in the circumstances" and the characterization of the claim for refund as an "alternate possibility"—suggesting a choice between treatments rather than an intention to both deduct the overstated income in a later year *and* claim a refund for part of the amount which comprised the basis for that deduction. The claim also contains the tentative statement that it is "predicated upon the possibility that the $1,150,000 which the taxpayer included among its assets * * * should not have been so included but rather should have reduced the 1963 taxable income of the taxpayer."

The trial court concluded that the above language was "not an absolute claim for reduction of plaintiff's 1963 income but a claim to be operative only on the occurrence of the 'possibility' that the Internal Revenue Service disallowed plaintiff's preferred treatment, a post-contract-completion loss deduction. Such a disallowance never occurred; in fact, the exact opposite took place—the deductions were allowed. Nowhere did the plaintiff put the Service on notice that even if it allowed the deduction in previously reported contract income as a loss plaintiff would still demand exclusion of the same item from 1963 income." Slip op. at 12.

Appellant argues that "there is nothing in 'the claim as framed' which made it contingent or conditional on anything." While it is true that there is no unequivocal language to the effect that the claim is operative only upon the disallowance of the later deduction, it is also true that the claim does not put the Service on notice that the taxpayer means to utilize both the later deduction and the refund claim. In light of the ambiguity of the claim itself, we believe it proper to examine the "other evidence" relied upon by the Claims Court to support its conclusion that the claim was contingent upon an event which never occurred.

The trial court principally relied upon testimony by three revenue agents that appellant's tax manager, Mr. Krugly, had

assured them that the refund claim was merely "protective"—*i.e.*, designed to preserve the claims from the running of the limitations period in the event that the later deduction was disallowed. The testimony of the revenue agents was supported by contemporaneous reports consistent with the testimony given. Mr. Krugly, however, denied that there was ever an express understanding that the refund claims would be abandoned if the later deduction was permitted. The trial judge obviously found the testimony of the three revenue agents to be more credible than that of appellant's tax manager. We find that there is adequate support in the record for this conclusion.

The trial court also relied on three other factors: (1) appellant filed with the Tax Court (concerning the 1961 tax year) a motion stating its belief that the original contract income reported in 1964 was properly accrued in that year; (2) appellant failed to file a refund claim for 1965, evidencing the "exclusively protective" nature of the 1960 (via the 1963 carryback) and 1961 (via the 1964 carryback) claims—the limitations period was about to expire for 1963 and 1964, but not for 1965; and (3) two revenue agents and a case manager testified that their allowance of the 1967 deduction was predicated on their understanding, obtained from appellant, that the claims for refund were merely protective and were not being pursued.

The Claims Court also relied upon the decision in *National Casket Co.* v. *United States*, 16 A.F.T.R. 1001 (S.D.N.Y. 1934), *aff'd per curiam*, 79 F.2d 1004 (2d Cir. 1935), *cert. denied*, 298 U.S. 672 (1936), which the court found to be "closely analogous." In *National Casket*, the taxpayer filed a claim for refund requesting that a deduction be allowed for its 1920 tax year in the event that the deduction was disallowed in 1919. The deduction for 1919 was in fact allowed, which led

the court to conclude that no valid claim was filed for 1920 "because the condition on which, in the claim as framed, the taxpayer asked for a deduction of this bonus payment in the year 1920, never occurred." 16 A.F.T.R. at 1002.

Appellant argues that this case differs from *National Casket,* as there is nothing in "the claim as framed" which made it contingent. While this may be literally true, it is undisputed that the claim led the Service to believe that it was conditioned upon the disallowance of the later deduction and that the taxpayer did nothing to disabuse the I.R.S. of this notion. Given the totality of circumstances surrounding this case, the I.R.S.'s belief that the claim was conditional was certainly reasonable. Appellant had ample opportunity—in drafting its claim and in its other communications with the I.R.S.—to inform the government that the claim was not so conditioned.[8] But by using such language as "alternate possibility" and affirming its earlier treatment of the contract income, appellant has drafted a claim that misled the I.R.S. into believing that the allowance of the 1967 deduction would render the 1960 claim moot. Given the purposes of the statute (section 7422(a)) and regulation (section 301.6402-2(b)(1)), as detailed below, we do not believe that such a claim for refund is sufficient under law.

In *Union Pacific R.R.* v. *United States,* 389 F. 2d 437, 442 (Ct. Cl. 1968), the court stated:

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[8] There is nothing wrong with filing a conditional claim per se. *See United States* v. *Kales,* 314 U.S. 186, 195-96 (1941); *Kellogg-Citizens National Bank* v. *United States,* 330 F.2d 635, 639 (Ct. Cl. 1964). However, if it was found that the claim was subject to a condition precedent and, as here, that condition never occurred, then a conditional claim would not be sufficient under law.

> The rule that a taxpayer cannot present one ground for refund in its claim and a different ground in its petition is designed both to prevent surprise and to give adequate notice to the Service of the nature of the claim and the specific facts upon which it is predicated, thereby permitting an administrative investigation and determination. In addition, the Commissioner is provided with an opportunity to correct any errors, and if disagreement remains, to limit the scope of any ensuing litigation to those issues which have been examined and which he is willing to defend. [Citations omitted.]

See also Forward Communications Corp. v. *United States*, 608 F. 2d 485, 508 (Ct. Cl. 1979); *Fruehauf Corp.* v. *United States*, 477 F. 2d 568, 575 (Ct. Cl. 1973).

This case presents the unusual situation where the claim adequately details the facts underlying it, but does not adequately apprise the I.R.S. that the "claim" itself is operative whether or not a later disallowance occurs. If the above purposes for requiring the filing of a claim for refund are to be served, then the Service must be reasonably alerted to the entire basis and purpose of the claim before it. Here, the formal claim filed stated that the taxpayer believed the inclusion in income of the contract proceeds for 1963 through 1965 and a later deduction for 1966 were proper, and the basis for the refund claim (due to the overinclusion of contract income for 1963) was an "alternate possibility." A fair reading of the claim would, and did, lead the I.R.S. to understand that the claim was only operative if the later deduction was disallowed. The "other evidence" cited by the Claims Court does not, in our opinion, conclusively prove that the claim was conditional, but it does demonstrate that the taxpayer failed to inform the I.R.S. that the claim was not dependent upon the treatment accorded to the later deduction.[9]

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[9] The testimony of the revenue agents is not used here, as

(Footnote continued on following page)

We therefore affirm the Claims Court's conclusion that the 1960 claim (via the 1963 carryback) must fail.

The 1961 Claim (via the 1964 Carryback)

On November 3, 1978, the United States Court of Claims granted the government's motion for partial summary judgment in this same action, and dismissed those portions of appellant's petition relating to the refund claim for 1961 (via the 1964 carryback). *Sun Chemical Corp.* v. *United States*, 218 Ct. Cl. 702. The reason for the court's holding was that an earlier Tax Court judgment[10] (based upon a compromise settlement) involving the 1961 tax year was res judicata for 1961, and therefore further litigation for this year was barred for all issues actually raised and issues that could have been presented.

Appellant is not deterred by the Court of Claims decision on this issue, and seeks to relitigate the question of whether the Tax Court judgment is res judicata on the 1961 claim. Appellant in its brief characterizes the Court of Claims grant of partial summary judgment as "interlocutory" in nature, and therefore subject to reconsideration. The court's dismissal of the 1961 claim, however, operated as an adjudication upon the merits, Court of Claims Rule 102(b)(3), and as a final judgment appealable to the Supreme Court through an application for certiorari. *United Foundation Corp.* v. *United States*,

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(Footnote continued from preceding page)

appellant assumes, for the purpose of "equitably estopping" appellant from asserting an otherwise valid refund claim. Rather, this evidence shows that appellant was content to leave the (otherwise reasonable) impression that its claim was contingent, and that there was no waiver by the I.R.S. of any defects in the formal claim.

[10] *Kollsman Instrument Corp.* v. *Commissioner*, No. 6605-65 (T.C., filed Dec. 8, 1969).

130 Ct. Cl. 666, 670 (1955). Clearly, the Court of Claims dismissal of the 1961 claim is res judicata and thereby bars appellant from relitigating this issue on appeal to this court.

Conclusion

In summary: (1) the 1960 claim (via the 1963 carryback) is barred by appellant's failure to file a sufficient claim for refund; and (2) the 1961 claim (via the 1964 carryback) is barred by res judicata. Accordingly, upon the basis of the parties' submissions and oral argument, the judgment of the Claims Court is affirmed.

AFFIRMED

APPENDIX B

ORDER OF THE UNITED STATES COURT OF CLAIMS GRANTING DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Entered: November 3, 1978

IN THE UNITED STATES COURT OF CLAIMS

No. 341-73

SUN CHEMICAL CORPORATION, a Delaware Corporation [Successor in Interest By Merger to Kollsman Instrument Corporation] *v.* THE UNITED STATES	Federal income tax; *res judicata;* failure to file refund claim.

Paul A. Teschner, for plaintiff. *Teschner Professional Corporation,* of counsel.

Kenneth R. Boiarsky, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant. *Theodore D. Peyser,* of counsel.

Before FRIEDMAN, *Chief Judge,* BENNETT and SMITH, *Judges.*

ORDER

This case is before the court on defendant's motion for summary judgment with respect to taxpayer's federal income tax causes of action for the taxable years 1961 and 1965. For 1961, the claim is that the taxpayer overstated its income for 1964 because certain items reported as income that year were in

fact not income; that actually the taxpayer had net operating losses for 1964; and that it was entitled to carry back those losses to reduce 1961 income. For 1965, the claim is that taxpayer's reported income was overstated.

We conclude on the basis of the pleadings and briefs, but without oral argument, that the 1961 claim is barred by *res judicata* and that the 1965 claim is barred because the plaintiff did not file a timely claim for refund.

1. In 1967 plaintiff amended its pending petition in the Tax Court seeking to carry back to 1961 alleged net operating losses for 1964. The amendment to the petition, according to the plaintiff, was "to allow a complete determination of Petitioner's Federal income tax liabilities" for 1961 and 1962, "the years at issue in this case." The Tax Court case was settled by stipulation of the parties, pursuant to which the Tax Court in 1969 determined that the plaintiff had deficiencies in its income taxes for 1961 and 1962. *Kollsman Instrument Corp. v. Commissioner,* No. 6605-65 (T.C., filed Dec. 8, 1969).[11]

A Tax Court judgment based on a compromise settlement is *res judicata* for the taxable years involved. *United States v. International Bldg. Co.,* 345 U.S. 502, 506 (1953); *Erickson v. United States,* 159 Ct. Cl. 202, 217, 309 F.2d 760, 768 (1962); *Maher v. United States,* 145 Ct. Cl. 701, 703-04, 172 F. Supp. 689, 690 (1959). Plaintiff contends that the Tax Court decision does not bar it from litigating whether it had net operating losses for 1964 that could carry back to 1961, if that issue was not litigated or determined in the Tax Court. But the only reason plaintiff wishes to litigate its 1964 income is to use its asserted losses in that year to reduce its taxes for 1961, and the Tax Court decision put to rest all questions concerning plaintiff's liability for the latter year. The Tax Court decision "bars further litigation not only on those aspects of the [1961] tax

[11] Plaintiff, Sun Chemical Corp., is the successor in interest by merger to Kollsman Instrument Corp.

which were actually raised but also on the issues which could have been presented." *Erickson, supra,* 159 Ct. Cl. at 216, 309 F.2d at 768. Plaintiff could have raised in the Tax Court suit the issue it now seeks to litigate in this court, but failed to do so.

2. Plaintiff did not file a refund claim for 1965. Under section 7422 of the 1954 Internal Revenue Code, we have no jurisdiction to consider the claim for that year.

Plaintiff attempts to excuse its failure to file a refund claim for 1965 on the ground that its refund claims for 1960 and 1961, filed in 1967 and 1968, gave the government notice that it also was claiming a refund for 1965. Its theory is that its claim for 1960 and 1961 was based upon carrying back to those years net operating losses reflecting the exclusion of income from a government contract, which previously had been erroneously included in income for 1963, 1964 and 1965, and that this claim necessarily put the government on notice that plaintiff also was asserting overpayment of taxes for the latter 3 years. A refund claim for a particular tax year, however, does not constitute a refund claim for a different tax year, even if the underlying legal and factual bases for the claims for the 2 years are the same. *Rosengarten v. United States,* 149 Ct. Cl. 287, 293-94, 181 F. Supp. 275, 278-79, *cert. denied,* 364 U.S. 822 (1960); *Union Pac. R.R. v. United States,* 182 Ct. Cl. 103, 115, 389 F.2d 437, 446 (1968); *Brigham v. United States,* 200 Ct. Cl. 68, 83 n.13, 470 F.2d 571, 579 n.13 (1972), *cert. denied,* 414 U.S. 831 (1973).

Plaintiff's filing with the Internal Revenue Service in July 1978 of an amended claim for refund for 1965, raising the issue it here seeks to litigate, was untimely and did not give us jurisdiction to consider the claim.

IT IS THEREFORE ORDERED that defendant's motion for partial summary judgment be granted and that plaintiff's petition in regard to the claims for the taxable years 1961 and 1965 be dismissed.[12]

BY THE COURT

/s/ DANIEL M. FRIEDMAN
Daniel M. Friedman
Chief Judge

Nov. 3, 1978

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[12] Plaintiff moves for leave to file a second amendment to the petition, the purpose of which "is formally to place in issue in the case the question whether Plaintiff timely filed a claim or claims for refund with respect to Taxpayer's 1965 year." We deny the motion since we hold that plaintiff has not filed a timely claim for 1965.

APPENDIX C

OPINION, FINDINGS OF FACT, AND CONCLUSION OF LAW OF THE TRIAL DIVISION OF THE UNITED STATES COURT OF CLAIMS

IN THE UNITED STATES COURT OF CLAIMS

TRIAL DIVISION

No. 341-73

(Filed May 24, 1982)

SUN CHEMICAL CORPORATION, a Delaware Corporation, [Successor in Interest By Merger to Kollsman Instrument Corporation]

v.

THE UNITED STATES

Claim for refund: I.R.C. § 7422(a); sufficiency of protective claim contingent on Commissioner's disallowance of plaintiff's deduction for a different year as notice of absolute claim, after Commissioner made no such disallowance.

Paul A. Teschner, attorney of record, for plaintiff. *Teschner Professional Corporation,* of counsel.

Kenneth R. Boiarsky, with whom was *Assistant Attorney General John F. Murray,* for defendant. *Theodore D. Peyser* and *Robert S. Watkins,* of counsel.

OPINION[13]

MILLER, *Trial Judge:* Plaintiff seeks recovery of overpayments of federal income taxes for the years 1960 and 1961 attributable respectively to the carryback of asserted net operating losses from the years 1963 and 1964.

[13] The trial judge's recommended decision and conclusion of law are submitted in accordance with Rule 134(h).

In November 1962 the taxpayer entered into a letter contract with the United States Air Force to engineer, design and fabricate operational prototypes of a geodetic and photo mapping system and a ground data processing subsystem. The objective was to provide a fast and accurate photographic and electronic system for obtaining aerial photographic and geodetic information to be used in producing precise maps and charts of the earth's surface. The aerial portion of the system was designed to be incorporated in Boeing RC-135A jet aircraft. The letter contract was superseded by a formal negotiated contract in April 1963. It was also contemplated that the prototype contract would be followed by a production contract, and the latter was in fact entered into in March 1964.

The prototype contract was in the fixed sum of $6,718,480, but was subject to the standard "Changes" clause authorizing the contracting officer to make changes in the contract specifications at any time and requiring the contractor to proceed with the changed contract subject to a subsequent equitable price adjustment for any increase or decrease in the cost of the work caused by such changes. As originally specified, work was to begin in January 1963 and be completed by May 1, 1965, prior to testing.

In the course of performance of the contract, engineers employed by plaintiff and the Air Force jointly worked out agreements on many engineering, design, specification and production changes, and the Air Force accumulated such changes and incorporated them in three successive formal contract change notifications ("CCNs") issued June 21, 1963, November 29, 1963 and May 26, 1964. The CCNs did not reflect any agreements with respect to the impact of the requested changes upon the plaintiff's costs, the delivery schedule, or the contract price.

Although many of the changes were put into effect during 1963, plaintiff did not submit its request for equitable adjust-

ment to the Air Force contracting officer until December 30, 1964. As revised by plaintiff on June 30, 1965, its request was that the $6,718,480 original contract price be equitably adjusted for the changes to a total of $12,246,685. The $5,528,205 (82 percent) increase was based upon $5,134,088 in additional costs and $394,117 in profit thereon.

The Air Force contracting officer initially disagreed with almost all of plaintiff's claim, taking the view that most of the changes should result in no cost increases or in cost decreases. On January 10, 1966, he issued his final decision allowing plaintiff only an additional $123,780 with respect to the changes. However, after plaintiff appealed the decision to the Armed Services Board of Contract Appeals, on September 26, 1967, the parties agreed to a total increase in the contract price of $2,000,000, in lieu of the $123,780.

Meanwhile plaintiff had to file income tax returns for the intervening years.

A taxpayer has the option of reporting income from long term contracts pursuant to one of several different methods of accounting: (1) the completed contract method; (2) the percentage of completion method; or (3) any other method, including ordinary accrual accounting, if the method chosen clearly reflects its income. Treasury Regulation on Income Tax (26 C.F.R.) § 1.451-3; G.C.M. 22682, 1941-1 C.B. 307. Under the completed contract method, generally the gross contract price of each long term contract is reported in gross income for the taxable year in which such contract is completed and costs properly allocable to the contract are deducted for the same year even if incurred earlier. Treas. Reg. § 1.451-3(d). Under the percentage of completion method, the portion of the gross contract price which corresponds to the percentage of the entire contract which has been completed during the taxable year must be included in gross income for such taxable year. From this sum all costs incurred during the taxable year with respect

to the long term contract are deducted in arriving at taxable income. Treas. Reg. § 1.451-3(c).

Plaintiff chose to compute its contract income for 1963 through 1965 pursuant to a percentage of completion method adapted to the circumstances of its situation. Because it deemed the changes too extensive to warrant reliance upon the original contract price as the measure of total receipts to be derived from the contract, plaintiff instead used its total estimated costs to completion plus a reasonable profit markup thereon as the basis for its computation of contract income in each year. It deemed its percentage of completion to be the equivalent of a fraction represented by its actual contract costs for the year over its total estimated costs to completion. It then applied such percentage of completion to the estimated total contract receipts to arrive at the amount to be included in gross income for each year. The record does not reflect with accuracy the receipts from this particular contract reported for each year, but it does show that for the three taxable years 1963 through 1965 plaintiff included in gross income from the prototype contract an aggregate of $10,142,787.

As already noted, to plaintiff's chagrin, on January 10, 1966, the Air Force contracting officer determined that the contract changes entitled plaintiff only to $123,780 in excess of the original $6,718,480 contract price, or a total of $6,842,260 rather than the $10,142,787. This caused plaintiff to recompute its income from the prototype contract, and it determined that it had a $4,359,000 loss on the contract. It deducted that sum on its 1966 tax return as a "Reduction of 1963-1965 claim against U.S. Air Force per 1/10/66 determination of Contracting Officer."

The period of limitations (as extended by agreement of the parties) for assessment of additional 1963 income tax and for filing of a claim for refund of tax for that year was due to expire on June 30, 1967. On April 13, 1967, plaintiff filed a protective

claim for refund of its 1960 income taxes, based upon an asserted net operating loss carryback from 1963 (hereinafter "the 1960 (via 1963 carryback) claim").

As also previously mentioned, on September 26, 1967, plaintiff and the Air Force resolved their controversy over the additional amount due on the contract by the allowance to plaintiff of $2,000,000 in lieu of the $123,780. This necessitated a further recomputation of the loss on the contract, which this time turned out to be $3,318,000, and plaintiff deducted that sum on its 1967 income tax return in lieu of the $4,359,000 loss previously deducted on its 1966 return.[14]

On May 13, 1968, plaintiff also filed a protective claim for refund of its 1961 income taxes based on an asserted net operating loss carryback from 1964 (hereinafter, "the 1961 (via 1964 carryback) claim").

Plaintiff never filed any similar claim asserting that it had overreported its income from its Air Force contract on its 1965 return.

No statutory notices of disallowance[15] of the 1960 (via 1963 carryback) claim and the 1961 (via 1964 carryback)

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[14] In the 1967 return the $3,318,000 deduction was described as "Claim settlement—U.S. Air Force (Note 1)." Note 1 stated:

> "Note 1—To a certain extent this deduction represents amounts previously deducted in 1966; upon I.R.S. audit (Years 1965-1966); however, the examining Agent disallowed the deduction, the taxpayer accedes to the deduction for the year 1966."

The obvious intent of the last clause, buttressed by the testimony of several witnesses, was to say that "the taxpayer accedes to the disallowance for the year 1966."

[15] I.R.C. § 6532(a) requires the Secretary of the Treasury or his delegate, the Commissioner of Internal Revenue to mail a notice of disallowance of a claim for refund to a taxpayer by certified or registered mail before the statutory period of limitations on filing suit therefor *begins to run.*

claim were ever sent to plaintiff. Instead the Internal Revenue Service ("I.R.S.") allowed the plaintiff's $3,318,000 deduction on its 1967 return on audit without adjustment. Despite such allowance, however, in this suit plaintiff seeks to deduct the same losses on its 1963, 1964 and 1965 returns with consequent loss carryback from 1963 to 1960 and from 1964 to 1961.

The government defends on the grounds: (1) that this court has already granted summary judgment in its favor on the 1961 (via 1964 loss carryback) claim and the 1965 claim; (2) that the remaining 1960 (via 1963 carryback) claim is not supported by a valid claim for refund filed with the Commissioner of Internal Revenue as required by I.R.C. § 7422(a);[16] and (3) that on the merits plaintiff has failed to establish that it overreported any income for 1963 under its method of accounting. It is determined herein that the government's first two defenses are valid, and, therefore, it is unnecessary to reach the third.

On November 3, 1978, this court entered an order in this case that granted defendant's motion for partial summary judgment and dismissed plaintiff's petition in regard to its claims for 1961 and 1965; the former because a 1969 Tax Court judgment determining the amount of plaintiff's tax deficiencies for 1961 is *res judicata* with respect to all issues which could have been presented in that proceeding, and the latter because plaintiff had failed to file a refund claim with the Commissioner of Internal Revenue for 1965. Plaintiff argues that this court's order on the 1961 issue is erroneous because the Tax Court has a jurisdiction limited to the determination of a deficiency or overpayment and may not award a judgment for a tax refund, and that such a court's decisions should not be afforded *res judicata* effect in this court. This argument is without merit because, despite its limited jurisdiction, the Tax Court's final

[16] All references are to the Internal Revenue Code of 1954, as amended.

determination is still conclusive in any other suit. *See* I.R.C. § 6512(a), (f). In any event, a trial judge of this court has no authority to reverse the decisions of its appellate division. *See Northern Helix Co.* v. *United States,* 225 Ct. Cl. ____, 634 F.2d 557 (1980).

We turn now to the sufficiency of plaintiff's application for a refund to advise the Commissioner of the grounds for plaintiff's claim in the present suit.

Section 7422(a) of the Internal Revenue Code provides that no suit shall be maintained for the recovery of any internal revenue tax alleged to have been erroneously collected until a claim for refund has been filed with the Secretary of the Treasury or his delegate according to the regulations established pursuant to law. Treasury Regulation § 301.6402-2(b)(1) (1963), promulgated under the authority delegated by the statute, provides that the claim must "set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof," and that no refund will be allowed "except upon one or more of the grounds set forth in the [timely] claim." This regulation has been upheld on numerous occasions. *Angelus Milling Co.* v. *Commissioner,* 325 U.S. 293, *reh'g. denied,* 325 U.S. 895 (1945); *Real Estate-Land Title & Trust Co.* v. *United States,* 309 U.S. 13, 17-18 (1940); *United States* v. *Felt & Tarrant Mfg. Co.,* 283 U.S. 269 (1931); *Commercial Solvents Corp.* v. *United States,* 192 Ct. Cl. 339, 347, 427 F.2d 749, 754, *cert. denied,* 400 U.S. 943 (1970).

In *Union Pacific RR.* v. *United States,* 382 [182] Ct. Cl. 103, 108, 389 F.2d 437, 442 (1968), this court stated:

> It is an undisputed general rule that a ground for refund neither specifically raised by, nor comprised within the general language of, a timely formal or informal claim for refund to the Internal Revenue Service cannot be considered by a court in which a suit for refund is subsequently initiated.

Even where the Commissioner has been made aware of all the material facts by a claim or claims for refund, in the absence of a waiver a taxpayer may not recover in a refund suit on grounds other than those asserted to the Commissioner in the claim as the basis for refund. *Real Estate-Land Title & Trust Co.* v. *United States, supra; Fruehauf Corp.* v. *United States,* 201 Ct. Cl. 366, 379, 477 F.2d 568, 575 (1973); *Commercial Solvents Corp.* v. *United States, supra.*

Although plaintiff now urges that the 1960 (via 1963 carryback) claim for refund gave the Commissioner notice of its claim that the inclusion of its Air Force contract income in its 1963 return was erroneous and it was entitled to deduct a loss on the contract for such year irrespective of whether or not it was allowed to deduct the same loss for 1966 or 1967, the wording of the claim does not support plaintiff's argument. It states:

> There was erroneously included in the 1963 income of Kollsman Instrument Corporation ("Taxpayer") the amount of 1,150,000 for the following reasons:
>
> During the years 1963, 1964, and 1965, Taxpayer was performing services for the United States Air Force in the development of AN/USQ-28 Geodetic and Photo Mapping System. As a result of those services, the Taxpayer recorded upon its books of account amounts attributable to the performance of said services during those years as follows:

Year	Amount of Claim
1963	$1,179,326
1964	1,750,497
1965	1,537,520
	$4,467,343

> As a result, at the opening of business on January 1, 1966, Accounts Receivable of Taxpayer included the aforementioned amount of $4,467,343 which Taxpayer

had included among its assets in the belief that all of the events had occurred which fixed the right of the Taxpayer to receive income from those services and in the further belief that the amount of that claim could be determined with reasonable accuracy.

During 1966, the Taxpayer attempted to procure from the United States Air Force an admission affirming that it did in fact owe the Taxpayer the amount so recorded on its books of account; but this attempt was unsuccessful when on January 10, 1966 a determination was made by the Contracting Officer that Taxpayer only had a right to receive the amount of $108,343 instead of the aforementioned amount of $4,467,343 which was determined as follows:

Year	Applicable To Claim	Determined To Be Allowed	Balance
1963	$1,179,326	$29,326	$1,150,000
1964	1,750,497	42,497	1,708,000
1965	1,537,520	36,520	1,501,000

Accordingly, *in computing its taxable income for 1966, the Taxpayer eliminated from its assets the amount of $4,359,000 and charged off the claim which it had recorded against the United States Air Force.* The amount of $4,359,000 was the adjusted basis of said portion of the claim as determined by the application of Section 1011 of the Internal Revenue Code of 1954.

Although the *Taxpayer believes that the aforementioned treatment is proper in the circumstances, it also recognized the alternative possibility* that the following provisions of Reg. Sec. 1.451-1(a) might apply:

> * * * (I)f, in case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. * * * (I)f a Taxpayer ascertains that an item was improperly included in a gross

> income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom. * * *
>
> *This claim for refund* is filed in an attempt to comply with the above Regulation Provision and *is predicated upon the possibility that the $1,150,000 which Taxpayer included among its assets on account of the aforementioned claim in the year 1963 should not have been so included but rather should have reduced the 1963 taxable income of the Taxpayer.* (Emphasis added.)

Plaintiff's statement in the claim that "the taxpayer believes that the aforementioned treatment [*i.e.*, the inclusion of the $4,467,343 in its accounts receivable and income for 1963, 1964 and 1965 and the charge-off of $4,359,000 in 1966] is proper in the circumstances" is just the opposite of what it now argues—that the original inclusion was erroneous. Its further statements that the claim was filed because it recognized "the alternative possibility" that its original treatment might have been contrary to a regulation and that the claim was "predicated upon the possibility that the $1,150,000 which the taxpayer included among its assets *** should not have been so included but rather should have reduced the 1963 taxable income of the taxpayer" is not an absolute claim for reduction of plaintiff's 1963 income but a claim to be operative only on the occurrence of the "possibility" that the Internal Revenue Service disallowed plaintiff's preferred treatment, a post-contract-completion loss deduction. Such a disallowance never occurred; in fact, the exact opposite took place—the deductions were allowed. Nowhere did the plaintiff put the Service on notice that even if it allowed the deduction in previously reported contract income as a loss plaintiff would still demand exclusion of the same item from 1963 income.

Other evidence in the record confirms defendant's view that plaintiff's 1960 (via 1963 carryback) claim for refund was intended by plaintiff and understood by the Internal Revenue

Service to be merely protective in the event of disallowance of the 1966 or 1967 loss deduction, and not to be operative if the loss deduction for 1966 or 1967 was allowed.

First, Revenue Agent Breitbart, who originally examined plaintiff's 1960, 1963 and 1964 federal income tax returns, testified that during the course of his examination plaintiff's tax manager, Mr. Krugly, told him that plaintiff did not expect to collect from the Air Force all of the money it had originally anticipated and reported in income for 1963, 1964 and 1965, that plaintiff was unsure as to the proper year to deduct the income earlier reported, and that plaintiff intended to file refund claims for 1963, 1964 and 1965 to safeguard plaintiff's interests in the event it did not receive the deduction for later years. Corroborating this testimony is Mr. Breitbart's letter of December 4, 1967, contemporaneously reporting to the district director of Internal Revenue at Chicago that plaintiff had claimed a deduction for the Air Force contract loss on its 1966 return and that "in addition protective claims were filed for 1963, 1964 and 1965."[17]

Second, Revenue Agent Markowitz, who examined plaintiff's tax returns for 1965 and 1966, and Revenue Agent Petchesky, who examined its 1967, 1968 and 1969 returns, both testified that an express understanding was reached between Krugly and themselves that upon allowance of the $3,318,000 deduction claimed in the 1967 return the 1960 (via 1963 carryback) claim and the 1961 (via 1964 carryback) claim were to be withdrawn. Revenue Agents Markowitz's and Petchesky's contemporaneous reports are consistent with their testimony. Markowitz's report for 1960, 1963 and 1965 to the Internal Revenue Service, dated July 23, 1971, stated that

[17] After plaintiff moved its main office from Brooklyn to Chicago, the responsibility for auditing plaintiff's returns was then transferred to the Chicago district director's office. Revenue Agent Breitbart's letter was in response to an inquiry from the Chicago office as to facts pertinent to completion of the audit reports.

taxpayer had agreed to the 1967 adjustment and was withdrawing its 1963 and 1964 claims since they were protective in nature. Petchesky's report to the Service, dated September 7, 1971, was to the same effect.

Third, plaintiff's treatment of its Air Force contract income for 1964 in its dealings with the Internal Revenue Service also reflects its representation that its claims attributable to 1963 and 1964 were intended to be merely protective in the event the Service disallowed its 1967 deduction. Plaintiff's 1961 (via 1964 carryback) claim, filed May 13, 1968, was substantially identical to its 1960 (via 1963 carryback) claim except for the amounts requested therein. Since at the time plaintiff had pending in the Tax Court a petition seeking redetermination of a 1961 income tax deficiency, it found it necessary to amend its petition in that case to include the claimed overpayment. Its amendment filed in September 1967, explained that plaintiff had included $1,750,497 in income for 1964 attributable to its Air Force contract but that after the Air Force had denied liability for all but $42,497 of that sum[18] plaintiff had charged off the $1,708,000 difference in its 1966 return. It reiterated its belief that such treatment was proper, but stated that, if it was not, then its 1964 income had been overstated by $1,708,000. The Commissioner filed a general denial. In May 1967, the parties agreed on a settlement of the deficiency at issue in the Tax Court case without giving plaintiff any allowance for the claimed overpayment. However, to insure that the settlement did not have the effect of implying that plaintiff did not correctly include the Air Force contract income in its 1964 return and correctly charge it off thereafter in 1966 or 1967, on June 18, 1968 (one month after the filing of its 1961 (via 1964 carryback) refund claim), plaintiff filed a motion for leave to reply to the government's general denial, together with a cover

[18] This was the portion of the $123,780 1966 Air Force allowance which plaintiff had allocated to its 1964 tax year.

letter to the clerk detailing the circumstances of its Air Force contract claim and settlement.

In its motion, plaintiff explained:

> the purpose of this Reply is to resolve the issue covering the includibility of certain items in income for the taxable years ended December 31, 1964, and to agree with the Respondent that such items were properly included in income for the taxable year ended December 31, 1964.

And in the cover letter, plaintiff further stated:

> In administrative proceedings Petitioner and Respondent are now resolving the question whether such loss and/or bad debt properly should be taken in 1966 or 1967. My information is that a Revenue Agent is currently considering denying the deduction for 1966 but suggesting perhaps, that it would be a proper deduction for 1967.
>
> There was and still is, of course, a possibility that Respondent could deny any deduction for either 1966 or 1967 upon the premise that the amount of $1,708,000 should never have been included in income in 1964. If that possibility eventuated, it is not clear that the Mitigation of Limitations provisions would protect the Petitioner.
>
> The only purpose for filing the aforementioned Motion is to place on record in Case No. 6605-65 the agreement of the Petitioner and Respondent that the amount of $1,708,000 was properly accrued as income in 1964. When that has been done, and when some action has been taken administratively concerning the proper year of deduction as between 1966 and 1967, then Case No. 6605-65 can be concluded.

Fourth, the exclusively protective nature of the 1960 (via 1963 carryback) and 1961 (via 1964 carryback) claims is also evidenced by the fact that plaintiff failed to file a refund claim for 1965. Had plaintiff felt that its accounting for 1963-1965 was erroneous in any event, it would have filed claims attributable to 1963, 1964 and 1965, not just the former two years. In

regards to 1963 and 1964, plaintiff was motivated to file the claims because the times for filing them were about to expire while allowance of plaintiff's deduction for 1966 or 1967 was still under consideration by the Service. Such a motivation did not exist for 1965, since, even if the Service eventually disallowed the 1966 and 1967 deductions, there was still ample time to file a 1965 claim (until at least March 15, 1969 (I.R.C. §§ 6072(b) and 6511(a)).

Finally, Revenue Agents Markowitz and Petchesky, and Case Manager Ryan testified that their allowance of taxpayer's 1967 charge-off of the income overreported for 1963, 1964 and 1965 was predicated on their understanding, obtained from plaintiff, that the claims for the earlier years were merely protective and were not being pursued.

The decision in *National Casket Co.* v. *United States,* 16 A.F.T.R. 100 (S.D. N.Y. 1934), *aff'd per curiam,* 79 F.2d 1004 (2d Cir. 1935), *cert. denied,* 298 U.S. 672 (1936), is closely analogous. It holds that a claim for refund which asked for a deduction in the year 1920 in the event of a failure to obtain it in the year 1919, was not a valid claim for 1920 after the taxpayer had the benefit of the 1919 deduction, "because the condition on which, in the claim as framed, the taxpayer asked for a deduction * * * in the year 1920, never occurred." 16 A.F.T.R. at 1002.

In *United States* v. *Kales,* 314 U.S. 186 (1941), the taxpayer filed a protest letter stating that in the event the Commissioner or any court decreased the March 1, 1913 value basis of shares of stock she had sold below a value he had previously fixed by ruling, she would insist that the value fixed by the ruling was itself too low, and that the tax paid on her sale was correspondingly excessive. After the Board of Tax Appeals reduced the valuation and the taxpayer invoked her threat, the court held that her protest letter was sufficient as a claim for refund. In so ruling, the Supreme Court relied upon the fact that the protest "fairly advise[d] the Commissioner of the nature of the taxpayer's claim" and had not been mis-

leading. *Id.* at 194. Further, the court's discussion of the fact that the contingency in the protest actually occurred, *i.e.*, a revaluation, implies that if this had not been true the claim might have been ruled insufficient.

Contingent and protective claims for refund are no strangers to the law. *United States* v. *Kales, supra; Kellogg-Citizens Nat'l. Bank* v. *United States,* 165 Ct. Cl. 452, 330 F.2d 635 (1964). But except for the *National Casket* case, neither party has cited any case where the taxpayer has contended that a claim for refund predicated upon a deduction from income in the event the Service disallows the taxpayer's asserted deduction of the same item in another year is sufficient, not only when the event does not occur, but where the antithesis of that event does occur.[19]

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[19] In *Crook* v. *United States,* 135 F. Supp. 242 (W.D. Pa. 1956), not cited by either party, defendant asserted that a claim for refund was insufficient because it was dependent upon a contingency which never occurred. But the defense was not well supported. The suit was for refund of income taxes for five years: 1940, 1942, 1943, 1944 and 1945. The issue was the same for all years: Whether the annual payments received by the taxpayer were the proceeds of the sale of patent rights give rise to capital gain or royalties for a license resulting in ordinary income. There was no contest as to the sufficiency of the claims for the last four years. But in the 1940 claim the taxpayer stated that the corporate payor had pending a Board of Tax Appeals proceeding in which it was contending that the payments were deductible royalties for 1940 rather than non-deductible capital expenditures, and that the taxpayer was filing her 1940 claim "in order to preserve the taxpayer's right to a refund if it is finally determined that this payment was not royalties on patents as it had been treated on her return. . . ." The Tax Court (successor to the Board of Tax Appeals) held that the corporation could not deduct the payments because they were not royalties but were voluntary payments which the corporation was not obligated to make at all. The District Court ruled that the claim asserted a present right, set forth facts sufficient to enable the Commissioner to make an intelligent administrative review, and was sufficient. The Court did not discuss the basis for these conclusions, and it is difficult to understand the government's contention that the contingency had not occurred, when, in fact, it had.

In *Union Pacific RR.* v. *United States,* 382 [182] Ct. Cl. 103, 108, 389 F.2d 437, 442 (1968), the court stated:

> The rule that a taxpayer cannot present one ground for refund in its claim and a different ground in its petition is designed both to prevent surprise and to give adequate notice to the Service of the nature of the claim and the specific facts upon which it is predicated, thereby permitting an administrative investigation and determination. [Citation omitted.] In addition, the Commissioner is provided with an opportunity to correct any errors, and if disagreement remains, to limit the scope of any ensuing litigation to those issues which have been examined and which he is willing to defend. [Citations omitted.]

And see also *Forward Communications Corp.* v. *United States,* 221 Ct. Cl. ____, ____, 608 F.2d 485, 508 (1979); and *Fruehauf Corp.* v. *United States,* 201 Ct. Cl. 366, 379, 477 F.2d 568, 575 (1973).

If these purposes are to be served by the claim for refund, then the plaintiff's claim cannot be deemed sufficient. For the Service was told by the claim that taxpayer's position was that the correct adjustment required by the Air Force's denial of additional compensation in 1966 was a deduction in that year and not an exclusion from 1963 income of the amount originally reported. Since plaintiff did not then contend that the inclusion in 1963 income was erroneous, there was no occasion for the Service to make an administrative investigation of whether the inclusion of the sum in 1963 income was erroneous or a proper exercise of discretion under the taxpayer's method of accounting during that year, and the correct amount thereof. There was no opportunity for the Service to determine administratively whether plaintiff's present contention is correct and, if so, to avoid litigation. Moreover, if it were held sufficient, the claim would have misled the Service into permitting itself to be whipsawed by allowing inconsistent deductions in two different years, or, at the least, having to defend this lawsuit and then to

prosecute another to recoup the income taxes for 1967 avoided by plaintiff's taking of a second deduction for the same item.[20]

FINDINGS OF FACT

1. At all times relevant to this case, the taxpayer, Kollsman Instrument Corporation ("Kollsman" or "taxpayer"), was a corporation chartered in the state of New York. Until December 29, 1972, taxpayer was a wholly-owned subsidiary of Standard Kollsman Industries, Inc. ("SKI"), an Illinois corporation. On that date, SKI, pursuant to a plan of reorganization, merged into the plaintiff, Sun Chemical Corporation, at which time taxpayer became the Kollsman Instrument Company Division of plaintiff.[21]

2. (a) In November of 1962, Kollsman and the Air Force entered into Letter Contract No. AF 33 (657)-10256 ("Letter Contract 10256" or "Letter Contract"). Under this contract, Kollsman was to furnish the services and materials necessary to conduct an engineering investigation and the fabrication of an airborne data collection (AN/USQ-28) subsystem and a ground data processing subsystem. In the Letter Contract,

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[20] If plaintiff were to prevail in the instant suit, the government would have to rely on the Mitigation of Effect of Limitations provisions of the Internal Revenue Code (Section 1311-1315) to prevent the taxpayer from receiving both the 1967 deduction and the 1960 (via 1963 carryback) refund. After the briefs were submitted, the parties were instructed to file supplemental memoranda on the availability of the mitigation statute for such a purpose. In response both the plaintiff and the government stated that it is unclear whether the mitigation provisions would be applicable to prevent a double recovery by the taxpayer. Taxpayer asserted that the mitigation statute's applicability is an issue to be contested in another proceeding brought by the government.

[21] The former Kollsman Instrument Corporation and the present Instrument Company Division of plaintiff will be referred to as "Kollsman" or the "taxpayer."

Kollsman's work was broken down into three phases, each of which was further subdivided into a number of Work Items. Phase I consisted of subsystem analysis and preliminary design, the objective of which was to formulate detailed planning procedures for the conduct of the latter two phases. Phase II consisted of the fabrication and integration of a AN/USQ-28 Subsystem in accordance with the preliminary design specification approved under Phase I. Phase III consisted of a flight test and evaluation to determine compliance of the subsystems with the contract requirements.

(b) Letter Contract 10256 specified a maximum price of $6,728,986, except that if the contract was terminated the maximum amount for which the government would be obligated would be $3,364,493.

3. (a) In Letter Contract 10256 the parties agreed to execute a definitive fixed-price contract in 1963.

(b) On April 4, 1963, Kollsman signed a definitive fixed-price contract, which was designated Negotiated Contract No. AF 33 (657)-10256. ("Negotiated Contract 10256" or "Negotiated Contract" or "Definitive Contract 10256" or "Definitive Contract"). Negotiated Contract 10256 was signed and approved by the Air Force in May of 1963.

(c) The Negotiated Contract differed from the Letter Contract in several regards, *to wit:* (1) it provided that the Distance Measuring Equipment was to have an accuracy of ± three feet; (2) it made changes in the delivery schedules and in the classification of certain work items; (3) it did not require the prior approval of the contracting officer before Kollsman could enter into any subcontract in excess of $50,000; (4) it required the Air Force to give all necessary notices of approval or disapproval with statements of reasons within a specified time; and (5) it obligated the Air Force to pay $6,718,480 to Kollsman rather than the $6,728,986 price provided by the Letter Contract and assigned prices to individual contract work items.

4. Under Negotiated Contract 10256 ("Pre-production Contract"), Kollsman was to fabricate operational prototypes of the AN/USQ-28 Geodetic and Photo Mapping system and a ground data processing subsystem ("USQ-28 System") which the parties contemplated would be the subject of a follow-on production contract for full scale manufacture of the system. In March 1964, a separate contract, designated Contract 12859 ("Production Contract"), was awarded to taxpayer by the Air Force for such manufacture.

5. The USQ-28 System was the first program awarded to Kollsman's newly formed Systems Management Division through which Kollsman hoped to expand its business in the systems field. It was planned to provide a fast and accurate photographic and electronic system for obtaining aerial photographic and geodetic information to be used in producing precise maps and charts of the earth's surface. The system was designed to be incorporated in the Boeing RC-135A jet aircraft.

6. The Definitive Contract included the standard "Changes" clause (*see* 41 C.F.R. 1-16.101 (1965)). This clause provided that:

> 2. CHANGES
>
> The Contracting Officer may at any time, by a written order, and without notice to the sureties, make changes, within the general scope of this contract, in any one or more of the following: (i) Drawings, designs, or specifications, where the supplies to be furnished are to be specially manufactured for the Government in accordance therewith; (ii) method of shipment or packing; and (iii) place of delivery. If any such change causes an increase or decrease in the cost of, or the work required for, the performance of any part of the work under this contract, whether changed or not changed by any such order, an equitable adjustment shall be made in the contract price or delivery schedule, or both, and the contract shall be modified in writing accordingly. Any claim by the Contractor for adjustment under this clause must be asserted

> within 60 days from the date of receipt by the Contractor of the notification of change; * * * Failure to agree to any adjustment shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled "Disputes." However, nothing in this clause shall excuse the Contractor from proceeding with the contract as changed.

7. (a) In the course of performance of the contract, engineers from Kollsman and the Air Force jointly worked out agreements on many engineering, design, specification and production changes. Pursuant to the Changes clause, the Air Force periodically incorporated such changes in formal Contract Change Notifications ("CCNs"). The CCNs did not necessarily precede the implementation of the changes. In some instances the changes had not yet been accomplished; in others, they were ongoing; and, in still others, they had been completed prior to the issuance of the CCN by the contracting officer. While each CCN stated the Air Force's unilateral view of the additional funds in its appropriation which were obligated to cover the estimated increase in price or the funds which would be deobligated to cover the estimated decrease in price resulting from the CCN, it also stated that the amount shown as obligated or deobligated was for administrative purposes only and would not affect the rights of either party to negotiate an equitable adjustment pursuant to the Changes clause. The CCNs did not reflect any agreements between the Air Force and Kollsman with respect to the impact of the requested changes upon the plaintiff's costs, the delivery schedule of the program or the contract price.

(b). Three CCNs were issued with respect to Negotiated Contract 10256. CCN 1 was issued June 21, 1963. CCN 2 was issued November 29, 1963. CCN 3 was issued May 26, 1964. Each subsequent CCN superseded and cancelled the prior one.

8. For each year pertinent to the instant litigation, the cost records of taxpayer's Systems Management Division were separately maintained for Contract 10256 and for Contract 12859. The cost records of taxpayer's Systems Management Division did not distinguish or separately identify costs incurred each year in connection with CCN changes as opposed to costs otherwise incurred under Contract 10256, and there are currently no books and records available to taxpayer which would permit such distinction or separate identification to be made. Thus, at the end of 1963, taxpayer was unable to estimate or quantify the extent to which costs had been incurred during that year for CCN changes as opposed to costs otherwise incurred under Contract 10256, and, consequently, at that time it could not estimate or quantify the total costs expected to be incurred for CCN changes.

9. (a) Negotiated Contract 10256 contained the standard "Disputes" clause, which provided, *inter alia*, that Kollsman could submit any factual disputes (*i.e.*, cost of a change) arising under the contract which could not be disposed of by agreement between the parties, to a contracting officer, whose resolution of the question would be final unless reversed by the Secretary of Defense (or subsequently by a court of competent jurisdiction) upon timely appeal.

(b) On December 30, 1964, Kollsman submitted to the Air Force a Request for Equitable Adjustment of the price and delivery schedules for Contract 10256. This equitable adjustment claim was broken down by Kollsman into ten categories of changes it believed were directed by the Air Force to be made. Kollsman claimed $5,146,137 as its additional cost on the Negotiated Contract due to these changes and $395,157 profit, for a total claim of $5,541,294. On June 30, 1965, it revised that document to reflect subsequent changes so that plaintiff's revised figures were $5,134,088 additional cost, $394,117 profit and a total $5,528,205.

(c) Kollsman's Request for Equitable Adjustment was weighted heavily towards material costs as opposed to labor costs. The percentages of profit on costs which Kollsman requested were computed by using the weighted guidelines promulgated in the Armed Services Procurement Regulations.

10. (a) During 1965, representatives of Kollsman and the Air Force held numerous meetings in an attempt to resolve Kollsman's claim. Kollsman took the position that the Air Force owed it additional money and the Air Force asserted that Kollsman owed the Air Force money. They were unable to reach a consensus and finally agreed to disagree on the merits of the Kollsman claims.

(b) On January 10, 1966, the Air Force contracting officer issued his final decision which denied, in part, Kollsman's request for an equitable adjustment, and determined that Kollsman was entitled only to an additional $123,780 with respect to the changes directed in Contract 10256.

(c) A supplemental agreement to Contract 10256 with an effective date of November 17, 1966, authorizing an increase in price of $123,780 was approved by Kollsman on March 9, 1967 and by the Air Force on March 10, 1967.

11. On September 22, 1966, Kollsman filed with the Armed Services Board of Contract Appeals an appeal from the contracting officer's decision on its equitable adjustment claim. On April 14, 1967, Kollsman filed an amended complaint which superseded the appeal filed September 22, 1966.

12. A supplemental agreement and modification of Contract 10256 with an effective date of June 15, 1967, authorizing an increase in price of $1,876,220 to Contract 10256, was approved by the Air Force on September 26, 1967. This amount (plus the $123,780 previously awarded) was awarded in full settlement of Kollsman's claim for equitable adjustment and appeal thereon.

13. Near the end of 1962 or the beginning of 1963, taxpayer formed the Systems Management Division to account for its operations in connection with the USQ-28 System.

14. (a) During 1963, the only contract accounted for by taxpayer's Systems Management Division was Contract 10256.

(b) During 1964 and subsequent years relevant to this litigation, the major contracts accounts accounted for by taxpayer's Systems Management Division were Contracts 10256 and 12859.

15. (a) For each year pertinent to the instant litigation, the sales records of taxpayer's Systems Management Division were maintained only on a division-wide basis, and were not maintained separately for Contracts 10256 and 12859, except for 1963 when Contract 10256 was the only contract accounted for by that Division.

(b) The cost records of taxpayer's Systems Management Division were maintained separately for Contract 10256 and 12859.

16. For purposes of its books and records and for its federal income tax returns,.taxpayer's method of accounting for Contract 10256 and 12859 was the cost percentage of completion method of accounting.

17. Taxpayer's reporting of income for the years 1963 through 1965 specifically including the results of its reporting under the cost percentage of completion method of accounting, and was certified in its annual reports for those years to be in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding years.

18. The net income reported for 1963 on taxpayer's books and records and in its federal income tax return for Contract 10256 is summarized as follows:

Sales	$ 2,644,584
Cost of Sales	(2,396,649)
Operating Profit	247,935
General and Administrative Costs	(244,514)
Net Income	$ 3,421

19. The net income reported for 1964 on taxpayer's books and records and in its federal income tax return, which net income was reported for the Division as a whole (without breakdown as to any particular contract), is summarized as follows:

Sales	$ 7,901,924
Cost of Sales	(6,807,753)
Operating Profit	1,094,171
General and Administrative Costs	(556,850)
Net Income	$ 527,321

20. The net income reported for 1965 on taxpayer's books and records and in its federal income tax return, which net income was reported for the Division as a whole (without breakdown as to any particular contract), is summarized as follows:

Sales	$ 9,892,406
Cost of Sales	(9,441,694)
Operating Profit	450,712
General and Administrative Costs	(586,693)
Net Income (Loss)	$ (135,981)

21. Under Kollsman's method of accounting for Contract 10256, costs incurred by Kollsman were not allocated to the CCNs themselves. There was no distinction made between the impact resulting from the CCNs as opposed to costs incurred under the basic contract.

22. Near the end of 1966, Kollsman estimated that its total cost for completing Contract 10256 would be $11,185,000. It further estimated that its total loss upon completion of Contract

10256 would be $5,090,000, and that its percentage loss to total cost would be 45.5 percent, calculated as follows:

Original contract 10256	$ 6,718,000
less "AGE" items	(568,000)
Balance	$ 6,150,000
less value of Fixed Services	(55,000)
Estimated contract-Basic	$ 6,095,000
Estimated cost to completion	(11,185,000)
Estimated loss to completion	$(5,090,000)
Percentage loss to total cost	45.5%

23. In its 1966 federal income tax return, taxpayer claimed a loss deduction in the amount of $4,359,000 computed as follows:

(a) The taxpayer applied the 45.5 percent loss factor to its figures for "Sales-Basic" for Contract 10256 for 1963, 1964 and 1965 to arrive at the amount of loss on such sales.

(b) The taxpayer allocated a portion of the $123,780 settlement made by the Air Force Contracting Officer on January 10, 1966 to each year, which, when subtracted from the losses calculated in (a), above, resulted in a net loss figure for each of the years 1963, 1964 and 1965, which figures in the aggregate totaled $4,359,000.

(c) The computation described in (a) and (b) above, is summarized as follows:

	1963	1964	1965
Sales-Basic	$2,591,925	$3,847,247	$3,379,165
Loss on Above at 45.5%	$1,179,326	$1,750,497	$1,537,520
Less 1/10/66 Offer	29,326	42,497	36,520
Net Loss	$1,150,000	$1,708,000	$1,501,000
Total Net Loss	$4,359,000		

(d) As explained by plaintiff's witness at trial, the $4,359,000 deduction claimed in taxpayer's 1966 federal income tax return represented its adjustment for an over-reporting of sales income on Contract 10256 for the three prior years.

24. In its 1967 federal income tax return, taxpayer claimed a deduction in the amount of $3,318,000. This deduction was the same item as the $4,359,000 deduction claimed in 1966, less an adjustment for the $2,000,000 final settlement award on Contract 10256, made by the Air Force in 1967. The reason for the $41,000 difference is not clear from the record.

25. Taxpayer's 1960, 1963 and 1964 federal income tax returns were examined by Internal Revenue Agent Breitbart. During the course of the examination, such revenue agent did not specifically focus on either the amounts of income reported for Contract 10256 or the method of accounting utilized by the taxpayer. In his report, dated April 14, 1967, Breitbart made no adjustment to sales, cost of sales, or inventories for 1963 or 1964, and instead accepted the figures reported therefor in the returns.

26. Incident to such audit, Revenue Agent Breitbart had discussions with Mr. Krugly, plaintiff's Tax Manager, in which the latter stated that the taxpayer did not then expect to collect from the Air Force all of the money that had originally been anticipated and reported into income for Contract 10256 during 1963, 1964 and 1965; that taxpayer was unsure as to which was the proper year to take a deduction with respect to the amounts reported in those earlier years; and that to safeguard taxpayer's interests in the event it did not receive the deduction in later years, taxpayer intended to file refund claims for 1963, 1964 and 1965. There was no discussion as to whether income had been properly included in 1963 through 1965 with respect to Negotiated Contract 10256. Such discussions took place prior to the filing of plaintiff's 1966 tax return, which is dated June 16, 1967.

27. On April 13, 1967, taxpayer filed a claim for refund for 1960, based upon an asserted net operating loss carryback from 1963. [Hereinafter that refund claim will be referred to as the "1960 (via 1963 carryback) claim."] Insofar as pertinent to the issue in this case, the claim for refund stated:

> There was erroneously included in the 1963 income of Kollsman Instrument Corporation ("Taxpayer") the amount of 1,150,000 for the following reasons:
>
> During the years 1963, 1964, and 1965, Taxpayer was performing services for the United States Air Force in the development of AN/USQ-28 Geodetic and Photo Mapping System. As a result of those services, the Taxpayer recorded upon its books of account amounts attributable to the performance of said services during those years as follows:

Year	Amount of Claim
1963	$1,179,326
1964	1,750,497
1965	1,537,520
	$4,467,343

> As a result, at the opening of business on January 1, 1966, Accounts Receivable of Taxpayer included the aforementioned amount of $4,467,343 which Taxpayer had included among its assets in the belief that all of the events had occurred which fixed the right of the Taxpayer to receive income from those services and in the further belief that the amount of that claim could be determined with reasonable accuracy.
>
> During 1966, the Taxpayer attempted to procure from the United States Air Force an admission affirming that it did in fact owe the Taxpayer the amount so recorded on its books of account; but this attempt was unsuccessful when on January 10, 1966 a determination was made by the Contracting Officer that Taxpayer only had a right to receive the amount of $108,343 instead of the aforementioned amount of $4,467,343 which was determined as follows:

Year	Applicable To Claim	Determined To Be Allowed	Balance
1963	$1,179,326	$29,326	$1,150,000
1964	1,750,497	42,497	1,708,000
1965	1,537,520	36,520	1,501,000

Accordingly, *in computing its taxable income for 1966, the Taxpayer eliminated from its assets the amount of $4,359,000 and charged off the claim which it had recorded against the United States Air Force.* The amount of $4,359,000 was the adjusted basis of said portion of the claim as determined by the application of Section 1011 of the Internal Revenue Code of 1954.

Although the *Taxpayer believes that the aforementioned treatment is proper in the circumstances, it also recognized the alternative possibility* that the following provisions of Reg. Sec. 1.451-1(a) might apply:

> * * * (I)f, in case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. * * * (I)f a Taxpayer ascertains that an item was improperly included in a gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom. * * *

This claim for refund is filed in an attempt to comply with the above Regulation Provision and *is predicated upon the possibility that the $1,150,000 which Taxpayer included among its assets on account of the aforementioned claim in the year 1963 should not have been so included but rather should have reduced the 1963 taxable income of the Taxpayer.* [Emphasis supplied.]

28. (a) The period of limitation for assessments of income tax for 1963 expired on June 30, 1967—the period had been extended to that date by agreement under Section 6501(c)(4) of the Code.

(b) By reason of the agreement referred to in (a), above, Taxpayer's 1960 (via 1963 carryback) claim was timely filed under Section 6511(d)(2) of the Code.

29. Taxpayer's federal income tax return for its calendar year 1966 was filed June 15, 1967.

30. Taxpayer's 1960 (via 1963 carryback) claim was assigned to Revenue Agent Breitbart at a point in time after his April 14, 1963 report, covering the years 1960, 1963 and 1964, had already been internally submitted for review.

31. On November 19, 1965, Kollsman filed a petition with the Tax Court of the United States, seeking a redetermination of the deficiencies in its income tax determined for its taxable years ended in 1961 and 1962 by Notice of Deficiency dated August 23, 1965. The case was docketed as Tax Court Case 6605-65. [Hereinafter the petition will be referred to as the "1961-62 Tax Court Petition" and the case as the "1961-62 Tax Court Case."]

32. On September 18, 1967, Kollsman filed a motion for leave to amend its 1961-62 Tax Court Petition, stating in support thereof that—

> the purpose of the Amendment is to bring before the Court Petitioner's taxable year ended December 31, 1964, a loss year, in order to allow a complete determination of Petitioner's Federal income tax liabilities for Petitioner's taxable years ended December 31, 1961, and December 31, 1962, the years at issue in this case.

The motion was allowed.

33. (a) Taxpayer's amendment to its 1961-62 Tax Court Petition alleged that "Respondent erred in failing to allow to Petitioner a net operating loss deduction for its taxable year ended December 31, 1961, in an amount sufficient to take into account as a component thereof a net operating loss carry back from Petitioner's taxable year ended December 31, 1964, of $2,665,914.58" based upon the following contentions:

(n).5. Petitioner erroneously included in its total income for its taxable year ended December 31, 1964, the amount of $1,708,000 for the following reasons:

(a) During the years 1963, 1964 and 1965, Petitioner was performing services for the United States Air Force in the development of AN/USQ-28 Geodetic and Photo Mapping System. As a result of these services, Petitioner recorded upon its books of account amounts attributable to the performance of said services during its taxable year ended December 31, 1964, which aggregated a total of $1,750,497.

(b) Petitioner included the aforementioned amount of $1,750,497 in its total income for its 1964 taxable year, and included among its assets as of December 31, 1964, an account receivable against the United States Government which incorporated said amount, in the belief that all of the events had occurred which fixed the right of the taxpayer to receive income from those services and in the further belief that the amount of that claim could be determined with reasonable accuracy.

(c) During 1966, the taxpayer attempted to procure from the United States Air Force an admission affirming that it did in fact owe the Petitioner, *inter alia,* the aforesaid amount of $1,750,497; but this attempt was insufficient when on January 10, 1966, a determination was made by the Contracting Officer that Petitioner only had a right to receive the amount $42,497 on account of the aforementioned claim of $1,750,497 which Petitioner had included in its 1964 total income.

(d) Accordingly, in computing its taxable income for 1966, Petitioner eliminated from its assets the amount of $1,708,000, the difference between its claim of $1,750,497 and the amount of $42,497 determined to be owing Petitioner by the Contracting Officer, and charged off the $1,708,000 claim which it had recorded against the United States Air Force. The amount of $1,708,000 was the adjusted basis of said portion of the claim as determined by the application of Section 1011 of the Internal Revenue Code of 1954.

(e) Although the Petitioner believes that the aforementioned treatment is proper in the circumstances, it also recognizes the alternative possibility that the following provisions of Reg. Sec. 1.451-1(a) might apply:

> * * * [I]f, in case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. * * * [I]f a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom. * * *

(f) If, under the Internal Revenue Code of 1954 and valid regulations enacted thereunder, the aforementioned amount of $1,708,000 should not have been included in Petitioner's assets on account of the aforementioned claim, then Petitioner overstated its total income for its taxable year ended December 31, 1964, by the amount of $1,708,000.

(b) Following the filing of Taxpayer's amendment to its 1961-62 Tax Court Petition, the government, by answer thereto filed November 6, 1967, denied each of the allegations set forth in Finding 33(a).

34. (a) On June 19, 1968, Taxpayer filed a motion with the Tax Court for leave to reply to the government's answer, stating in support thereof that:

> the purpose of this Reply is to resolve the issue covering the includibility of certain items in income for the taxable years ended December 31, 1964, and to agree with the Respondent that such items were properly included in income for the taxable year ended December 31, 1964.

(b) The cover letter, dated June 18, 1968, to Taxpayer's motion, which was addressed to the Clerk of the Tax Court

from Petitioner's counsel of record, stated by way of explanation that:

> Case No. 6605-65 was scheduled for trial on May 1, 1967 but, literally on the eve of trial, a basis for settlement was agreed upon between Petitioner and Respondent.
>
> Although the legal issues in the case had all been resolved, after the "basis for settlement" report had been made to the Court on May 1, 1967, subsequently the Appellate Division decided that it wished to resolve in this case sundry issues affecting other years.
>
> As a consequence, Petitioner was requested to expand the pleadings to bring into the case the taxable year ended December 31, 1964. This was done when Petitioner filed a Motion For Leave To Amend Petition on September 11, 1967; that Motion was granted on September 12, 1967, Regional Counsel having noted no objection to it.
>
> This procedure would have been routine were it not for one subsequent development, to wit, the incurrence by Petitioner of a loss and/or bad debt in 1966 or 1967. During the year 1964, the year which had been brought into the case at Respondent's request, Petitioner had included in its income the amount of $1,708,000 upon the theory that it was entitled to receive that amount for services performed for the United States Air Force.
>
> Subsequently, in 1966, a determination was made by a Government contracting officer that Petitioner was not entitled to receive that amount which it had accrued in 1964. Accordingly, Petitioner claimed a loss and/or bad debt deduction for 1966. In administrative proceedings Petitioner and Respondent are now resolving the question whether such loss and/or bad debt properly should be taken in 1966 or 1967. My information is that a Revenue Agent is currently considering denying the deduction for 1966 but suggesting perhaps, that it would be a proper deduction for 1967.
>
> There was and still is, of course, a possibility that Respondent could deny any deduction for either 1966 or 1967 upon the premise that the amount of $1,708,000 should never

have been included in income in 1964. If that possibility eventuated, it is not clear that the Mitigation of Limitations provisions would protect Petitioner.

The only purpose for filing the aforementioned Motion is to place on record in Case No. 6605-65 the agreement of the Petitioner and Respondent that the amount of $1,708,000 was properly accrued as income in 1964. When that has been done, and when some action has been taken administratively concerning the proper year of deduction as between 1966 and 1967, then Case No. 6605-65 can be concluded.

(b) On June 19, 1968, the taxpayer filed a reply to the government's answer, which stated in pertinent part that the Petitioner:

> Admits that the denial of Respondent with respect to paragraph 5, subparagraph (n) .5 of the Amendment to Petition was correct and further admits that the Petitioner properly included in its total income for its taxable year ended December 31, 1964, the amount of $1,708,000 attributable to the performance of services for the United States Air Force in the development of AN/USQ-28 Geodetic and Photo Mapping System during its taxable year ended December 31, 1964.

35. By letter dated May 9, 1969, the Regional Counsel of the Internal Revenue Service mailed to Kollsman's counsel an original and copies of a stipulation and decision which reflected a basis for a proposed settlement in Tax Court Case 6606-65. In part, the letter read:

> On September 12, 1967, the petitioner filed an amendment to petition in the subject case. In that document, petitioner alleged that it had erroneously included in its total income for the taxable year ended 1964, the amount of $1,708,000.00.
>
> On November 2, 1967, the respondent filed an answer to amendment to petition wherein the allegations concerning the $1,708,000 were denied. On June 20, 1968, the petitioner filed a reply to answer to amendment to petition.

Contained therein, is the admission that the denial of respondent with respect to paragraph 5.(n)(5) of amendment to petition was correct and it is stated "* * * further admits that the Petitioner properly included in its total income for its taxable year ended December 31, 1964, the amount of $1,708,000 attributable to the performance of services for the United States Air Force in the development of AN/USQ-28 Geodetic and Photo Mapping System during its taxable year ended December 31, 1964."

Actually, the respondent did not make such allegations which are purportedly being admitted in the aforesaid reply filed by the petitioner. Although we have some question as to the correctness of filing a reply in this case under the rules of the Court, we did not pursue the matter but we do wish it to be clearly understood that we are in no way to be held to be agreeing to the allegations in the reply to answer to amendment to petition filed by the petitioner on June 20, 1968.

In the amendment to petition filed on September 12, 1967, it is alleged in paragraph 2.(n)(5)(d) that the petitioner in computing its taxable income for 1966 eliminated from its assets and charged off the amount of $1,709,000.00. [*sic*] Since the year 1966 is not before the Court, we have not given any consideration to the correctness of deducting the $1,708,000.00 in 1966 or in any other year. Our sole consideration on this issue is whether or not 1964's net operating loss was understated by the $1,708,000.00.

In conference with the representatives of the Appellate Division and this office, the petitioner was requested to prove its allegations concerning the $1,708,000.00. It is the respondent's view that satisfactory evidence was not submitted and accordingly, respondent would not agree that the error as alleged in the petition was committed.

36. (a) After the assignment to Revenue Agent Breitbart of Taxpayer's 1960 (via 1963 carryback) claim, an internal memorandum inquiry, dated September 25, 1967, was received by Breitbart's New York Office from the Chicago office of the Internal Revenue Service, which was involved with Taxpayer's

Tax Court litigation, requesting background information on Contract 10256. [Hereinafter "Monasee Inquiry".]

(b) Following the receipt of the Monasee Inquiry, based on information supplied by the Taxpayer, Breitbart drafted a response [hereinafter "Monasee Response"] by letter dated December 4, 1967, which summarized: (1) the mechanics of Taxpayer's method of accounting for Contracts 10256 and 12859; (2) the sales actually reported under Contract 10256 and the reasons therefor; (3) the Taxpayer's "loss" computation on Contract 10256 and its actions thereon; and (4) the results of Kollsman's 1967 settlement with the Air Force.

(c) The letter concluded by stating:

> Thus in the opinion of the [Brooklyn] office, the income of the contract in question was properly included in the years 1963, 1964, and 1965 and the adjustment subsequently determined is deductible in the year 1967 when the dispute was finalized. In making the above determination, no consideration was given to the applicability or effect, if any, of Section 1481 and 1482 I.R.C.

(d) The factual information and figures contained in the Monasee Response were obtained from Taxpayer, and were not verified by the Internal Revenue Service with Taxpayer's books and records.

37. On May 13, 1968, taxpayer filed a refund claim for 1961, based on an asserted net operating loss carryback from 1964. [Hereinafter referred to as the "1961 (via 1964 carryback) claim."] Insofar as pertinent to this case, the claim stated the identical language set forth in the 1960 (via 1963 carryback) claim (see Finding 27), except that the first and last sentences thereof stated:

> There was erroneously included in the 1964 income of Kollsman Instrument Corporation ("Taxpayer") the amount of $1,708,000 for the following reasons:
>
> * * * *
>
> This claim for refund is filed in an attempt to comply with the above Regulation Provision and is predicated upon the

possibility that the $1,708,000 which the Taxpayer included among its assets on account of the aforementioned claim in the year 1964 should not have been so included but rather should have reduced the 1964 taxable income of the Taxpayer.

38. The 1961-62 Tax Court case was decided by the Tax Court on December 5, 1969, expressly adopting and incorporating the parties' stipulation submitted therewith (see Finding 35). Although the parties' stipulation specifically acknowledged the filing of Taxpayer's 1961 (via 1964 carryback) claim on May 13, 1968, no loss carryback was allowed in that stipulation with respect to the issue presented in that claim.

39. Taxpayer did not file a claim for refund for its taxable year 1965, or for any other taxable year as a loss carryback from 1965, with respect to any issue related to those in the instant action.

40. Taxpayer's consolidated federal income tax return for its calendar year 1967 was filed on September 16, 1968.

41. (a) Taxpayer's 1965 and 1966 federal income tax returns were examined by Revenue Agent Markowitz.

(b) Taxpayer's 1967, 1968 and 1969 consolidated federal income tax returns were examined by Revenue Agent Petchesky.

42. During 1967, after Revenue Agent Breitbart's preparation of the Monasee Response, the 1960 (via 1963 carryback) claim was internally transferred to Agent Markowitz for the latter's consideration in connection with his audit of Taxpayer's 1966 return. The transfer occurred because:

(a) Revenue Agent Markowitz had already begun his audit examination of Taxpayer's 1966 return, and

(b) the claim was understood by Breitbart to be directed primarily toward the allowance of a deduction in Taxpayer's taxable year 1966, with the assertions regarding 1960 (via 1963

carryback) being presented only as a "protective" matter if the later deduction was not allowed.

43. During the course of the audit of Taxpayer's 1966 tax return, prior to the filing of Taxpayer's 1967 return, Revenue Agent Markowitz preliminarily determined that the deduction of $4,359,000 claimed for 1966 was not allowable and, although not in charge of the examination of Taxpayer's 1967 return, he concurred with Breitbart's conclusion in the Monasee Response that the deduction with respect to this item should be properly allowed in 1967.

44. (a) In Taxpayer's 1967 consolidated federal income tax return, a deduction of $3,318,000 was labelled "Claim settlement—U.S. Air Force (Note 1)." Note 1 stated:

> Note 1 — To a certain extent this deduction represents amounts previously deducted in 1966; upon I.R.S. audit (Years 1965-1966); however, the examining Agent disallowed the deduction, the taxpayer accedes to the deduction for the year 1966.

(b) Prior to filing the 1967 consolidated tax return, the substance of footnote 1 thereto, set out in Finding 44(a), above, was discussed by Mr. Krugly with Revenue Agent Markowitz. As disclosed in that conversation the purpose of that footnote was to state Taxpayer's acquiescence to the proposed disallowance of the 1966 deduction in lieu of a deduction with respect to the same item in the 1967 return.

45. Due to a move of Taxpayer's offices, the audit of Taxpayer's 1967 return was not handled by Revenue Agent Markowitz, but rather by Revenue Agent Petchesky. However, for purposes of the issues herein, including the meeting with Taxpayer's representatives, the 1966-67 audit was a matter of joint participation because the same item of deduction was involved for both years.

46. (a) An express understanding was reached between Messrs. Markowitz, Petchesky and Krugly that upon allowance of the $3,318,000 deduction claimed in the 1967 return, the

1960 (via 1963 carryback) claim and the 1961 (via 1964 carryback) claim were to be withdrawn.

(b) An Internal Revenue Agent's "transmittal letter" is an internal document, generally not supplied to the Taxpayer, which is prepared by him for his superiors and which contains any other information deemed pertinent to the audit. The transmittal letter is attached to the Revenue Agent's draft of the audit examination report. The understanding referred to in Finding 46(a) was recorded in the transmittal letters of Revenue Agent Markowitz, dated July 23, 1971, covering Kollsman's taxable years 1960, 1963, 1965 and 1966, and of Revenue Agent Petchesky, dated September 7, 1971, covering Taxpayer's consolidated taxable years 1967, 1968 and 1969.

(c) Agent Markowitz stated in his July 23, 1971 report with respect to the 1960 loss carryback claim from 1963:

> (2) A claimed overstatement of accrued income included in the 1963 year in the amount of 1,150,000—on the percentage of completion basis in connection with a U. S. Air Force Contract (AF 33 (657/10256). This was in the nature of a protective claim.
>
> * * * *
>
> In addition to its adjustment for $4,359,000 in its 1966 return, KIC also filed claims for the years 1963 and 1964 as an "alternative possibility" predicated "upon the possibility" that amounts which taxpayer included among its assets in those years should not so have been treated. These were in effect protective claims within the period of limitation. It was also indicated to the examiner that, if necessary, a timely claim for 1965 would also be filed.
>
> * * * *
>
> As verified by a telephone conversation with Regional Counsel James F. Kennedy, who was assigned to the 1964 [Tax Court] case, and in writing by subsequent receipt of the action memorandum, the 1964 claim was withdrawn. Taxpayer has agreed to this adjustment and subsequently deducted the corrected applicable amount in 1967 giving

full consideration to the 2,000,000 received. This on the original return as filed thus eliminating any rollover adjustment or overassessment. Finally, taxpayer has agreed to and is withdrawing the claim for 1963 in part or as it related to the Air Force Contract #10256.

(d) In his report of September 7, 1971 with respect to the years 1967-1969, Revenue Agent Petchesky summarized the information he had received from Taxpayer with respect to the circumstances of the preproduction contract, the reporting of the income and loss and the filing and withdrawal of the claims for refund, in part, as follows:

On March 6, 1963 taxpayer entered into a negotiated fixed-price contract with the United States Air Force for the production of a mapping and survey subsystem known as AN/USQ28. The contract price with included ground support and related data was $6,718,480. Delivery under the contract was scheduled to cover the period commencing with the contract award and extending through May 1, 1965. Taxpayer elected pursuant to Reg. 1.451-3 to report income on this contract under a percentage of completion method.

* * * *

Contract analysis indicates that during the years 1963 and 1964 sales and cost of sales of $6,629,101 and $5,884,934 respectively were reported for both bank and tax purposes.

Taxpayer was apparently aware of the developing problem sometime prior to 12/31/64. A submission dated 12/31/64 entitled "Request for Equitable Adjustment" amounting to an additional $5,541,294 was made by taxpayers to the Air Force. Said "Request for Equitable Adjustment" was predicated upon CCN # 1, 2 and 3 (Contract Change Notification) dated 6/21/63, 11/29/63 and 5/26/64 respectively, and other non-formalized changes.***

In 1965, management still confident of the validity of their claim recorded sales and cost of sales of $3,513,686 and $3,544,365. *** Management judgment was con-

curred in by Price Waterhouse who in certifying the 1965 financial statement issued the statement reflecting incomes as indicated above with a qualification to their opinion.

In 1966, the contracting officer offered taxpayer $123,780 on its claim of $5,528,205 as revised 6/30/65 (original claim $5,541,294). Taxpayer deemed this settlement unacceptable and filed an appeal in accordance with the Disputes provisions. At 12/31/66 the matter had not been resolved, however, in the 1966 return taxpayer claimed a deduction of 4,359,000 which was comprised of sales included in income through 12/31/66 in excess of contract price adjusted for overall contract loss. Additionally, taxpayer filed protective claims for 1963 and 1964. Revenue Agent during the examination of the 12/31/66 year disallowed the deduction based upon the fact that inasmuch as taxpayer was litigating the claim, transaction was not closed and the loss may only be claimed in the year of fiscal [final] determination. At the time the Revenue Agent made this determination, the 1967 return had not been filed and the $5,528,205 claim was settled for $2,000,000 (inclusive of $123,780 increase of 11/17/66) on 6/15/67. In the 1967 return filed for the consolidated group, taxpayer deducted $3,318,000 under the caption "other deductions" designating this amount as claim settlement—U. S. Air Force. Claims referred to above for 1963 and 1964 have been withdrawn.

47. (a) In June of 1970, Mr. Bernard H. Ryan was assigned as a Case Manager with the Internal Revenue Service in Chicago to manage the overall audit examination of, *inter alia,* the consolidated federal income tax returns for 1967, 1968 and 1969 of SKI, which returns had been filed in Chicago. As part of his duties as Case Manager of SKI's 1967-69 consolidated returns, which returns included Taxpayer as part of the consolidated group, Mr. Ryan was also responsible for subsidiary examinations of Taxpayer then under way for those years and further was responsible for coordinating the audits of other tax years which might affect the determinations for 1967-69. Because the issues being considered for Taxpayer by Revenue Agents Markowitz and Petchesky "were going to fall into, and

affect our years," Mr. Ryan became directly involved in the coordination and resolution of those examinations as part of his case management responsibilities.

(b) In the ordinary course of his responsibilities, Mr. Ryan coordinated and conferred with Revenue Agents Markowitz and Petchesky and was supplied with copies of their "transmittal letters" and proposed examination reports during the summer or fall of 1971.

(c) Following review by Mr. Ryan, the Chicago Internal Revenue Service review staff, and the Congressional Joint Committee on Taxation of the "transmittal letters" and proposed examination report of Revenue Agents Markowitz and Petchesky, the "30-day letter"[22] covering the years 1960, 1963, 1965 and 1966 was forwarded to Taxpayer on February 28, 1972, and the "30-day letter" covering the consolidated years 1967-69 was forwarded to SKI on a date not disclosed by the record.

(d) The "30-day letter" covering the years 1960, 1963, 1965 and 1966 states, in part:

> Year Ended 12/31/63
>
> (C) Claim Denied in Part (1,150,000)
>
> In a timely claim filed on April 13, 1967 containing two issues taxpayer asserted in * * * the larger issue that 1,150,000 of income accrued on the books and included in the tax return for the year 1963, applicable to the development of Geodetic and Photo Mapping system was reported as taxable income on the percentage of completion method in error. This claim is denied with respect to this issue inasmuch as it is held that the income was properly included in the year 1963 under Section 451 of the Internal Revenue Code of 1954 and the regulations thereunder. Taxpayer agrees to this adjustment.

and

---

[22] A "30-day letter" is essentially a copy of the audit examination report, submitted to the taxpayer after review.

EXPLANATION OF ITEMS

Year Ended 12/31/66

(D) Reduction in 1963-5 Claim Against U.S. Air Force

Percentage of Completion Method *$4,359,000*

Kollsman Instrument Corp., for the Calendar Years 1963, 1964 and 1965, accrued and included in income unbilled estimated revenues deemed earned for long term fixed price contracts in process, on the percentage of completion method, including amounts applicable to directed contract changes subsequent to the issuance of the original contract, based on management's determination that all of the events had occurred which fixed the right to receive such income and the amount was reasonably accurate. This was accepted in Revenue Agent's reports for the years 1963 and 1964.

In 1966 differences developed as to the contract amount and, although Kollsman Instrument Corporation appealed under the disputes article of the contract to the Armed Services Board of Contract Appeals, it adjusted its 1966 taxable income for the difference between its original estimates and what it deemed to be an unacceptable offer of settlement. The exact amount was determined and received in 1967.

It is held that the adjustment to income required is not applicable to 1966 but should be made for federal income tax purposes in 1967, the year of the final determination in amount, based on regulations 1.451.1(a) which states in part as follows:

> Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made.

Based on the above the adjustment claimed is eliminated from the computation of taxable income for the year 1966.

48. The relevant substance of the "30-day letter" covering the years 1967-69 is that the $3,318,000 deduction claimed in the 1967 return was allowed without adjustment.

49. Some time after February 28, 1972 (when the "30-day letters" were issued) and prior to September 29, 1972 (when the "90-day letter" was issued—see Finding 50), Mr. Ryan had several conversations with Mr. Krugly, which led to a conference with Mr. Katz, an officer of the Taxpayer. At their meeting, Mr. Katz only related his concern as to how long Taxpayer would have to pay the $2,230,954 deficiency proposed for 1966. "There was no disagreement with any issue, but (in Mr. Ryan's words) any of the claims which were being acted upon and withdrawn, there was no argument that they (sic) were incorrect determinations in the reports."

50. On September 29, 1972, a so-called "90-day letter" was forwarded to Taxpayer which determined an overassessment for 1965 of $137,840 and a deficiency for 1966 of $2,330,954. Therein, *inter alia,* the $4,359,000 deduction which had been claimed in the 1966 return was disallowed, with the following explanation:

> During the year 1963, you entered into a preproduction fixed price contract with the United States Air Force for the fabrication of an airborne data collection and ground data processing system. Subsequently, in 1964 you entered into a follow-up fixed price production contract. On your 1966 return, you claimed a deduction in the amount of $4,359,000.00 for a loss with respect to such contracts.
>
> It is determined, with respect to these contracts, that you realized a loss of $3,318,000.00 in the year 1967, as reflected on your 1967 return, rather than realizing a loss of $4,359,000.00 in the year 1966. Therefore, the claimed deduction of $4,359,000.00 for the year 1966 is disallowed and your taxable income is increased accordingly.

51. The amounts of income which had been reported by Taxpayer under its cost percentage of completion method of accounting for 1963, 1964 and 1965 were accepted in the Internal Revenue Service audit examination without change.

52. Pursuant to Section 6501(d)(4) of the Internal Revenue Code of 1954, consents on Form 872 ("Consent Fixing Period of Limitation Upon Assessment of Income Tax") were executed extending the period of limitation for Kollsman's taxable years 1965, 1966 and 1967 until September 30, 1972.

53. The amounts of income reported by the taxpayer under its cost percentage of completion method of accounting for the taxable years 1963, 1964 and 1965 were accepted in the Internal Revenue Service audit without change.

54. If there had been any indication from Taxpayer that the 1960 (via 1963 carryback) or 1961 (via 1964 carryback) claims were being affirmatively pursued, Revenue Agents Markowitz and Petchesky, and Case Manager Ryan would not have recommended the allowance of the deduction claimed by and allowed to the Taxpayer for 1967.

CONCLUSION OF LAW

Based upon the foregoing findings of fact and opinion, it is concluded that the petition should be dismissed and judgment entered for the defendant.

APPENDIX D

JUDGMENT OF THE UNITED STATES COURT OF APPEALS

Entered: January 26, 1983

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

SUN CHEMICAL CORPORATION,
A Delaware Corporation,
Appellant,

v.

THE UNITED STATES,
Appellee.

No. 341-73

JUDGMENT

ON APPEAL FROM THE UNITED STATES CLAIMS COURT

THIS CAUSE HAVING BEEN HEARD AND CONSIDERED, IT IS

ORDERED AND ADJUDGED: AFFIRMED.

ENTERED BY ORDER OF THE COURT
/s/ GEORGE E. HUTCHINSON,
Clerk

Dated January 26, 1983
Appellant's Petition for Rehearing and Suggestion for Rehearing En Banc; DENIED, February 28, 1983.

ISSUED AS A MANDATE: March 8, 1983

APPENDIX E

ORDER OF THE COURT OF APPEALS DENYING THE SUGGESTION FOR REHEARING EN BANC AND THE PETITION FOR REHEARING

Entered: February 28, 1983

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

SUN CHEMICAL CORPORATION, A Delaware Corporation, etc., *Appellant,* v. THE UNITED STATES, *Appellee.*	No. 341-73

ORDER

A suggestion for rehearing en banc and a petition for reconsideration having been filed in this case,

UPON CONSIDERATION THEREOF, it is Ordered by the court that the suggestion for rehearing en banc and the petition be, and the same are hereby, Denied.

FOR THE COURT:
/s/ GEORGE E. HUTCHINSON
Clerk

February 28, 1983

By W. RICHARD SIENKIEWICH

APPENDIX F

CONSTITUTIONAL PROVISIONS INVOLVED

CONSTITUTION OF THE UNITED STATES OF AMERICA

* * *

ARTICLE III.—JUDICIAL POWER.

Section 1. Supreme Court and inferior courts—Judges and compensation.

The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behavior, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.

Section 2, Clause 1. Subjects of jurisdiction.

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority,—to all Cases affecting Ambassadors, other public Ministers and Consuls;—to all Cases of admiralty and maritime Jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—between a State and Citizens of another State;—between citizens of different States,—between citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Sec. 2, Cl. 2. Jurisdiction of Supreme Court.

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

* * *

AMENDMENT 5

No person shall * * *; nor shall any person * * * be deprived of life, liberty, or property, without due process of law; * * *

APPENDIX G

PROVISIONS OF UNITED STATES CODE INVOLVED

TITLE 26—INTERNAL REVENUE CODE

* * *

§ 63. Taxable income defined.

(a) General rule. Except as provided in subsection (b), for purposes of this subtitle the term "taxable income" means gross income, minus the deductions allowed by this chapter, other than the standard deduction allowed by part IV (sec. 141 and following).

(b) Individuals electing standard deduction. In the case of an individual electing under section 144 to use the standard deduction provided in part IV (sec. 141 and following), for purposes of this subtitle the term "taxable income" means adjusted gross income, minus—

(1) such standard deduction, and

(2) the deductions for personal exemptions provided in section 151.

(Aug. 16, 1954, c. 736, 68A Stat. 18.)

* * *

§ 172. Net operating loss deduction.

(a) Deduction allowed. There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) Net operating loss carrybacks and carryovers.

(1) Years to which loss may be carried.

(A)(i) Except as provided in clause (ii) and in subparagraphs (D), (E), (F), and (G), a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss.

(ii) in the case of a taxpayer with respect to a taxable year ending on or after December 31, 1962, for which a certification has been issued under section 317 of the Trade Expansion Act of 1962, a net operating loss for such taxable year shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss.

(B) Except as provided in subparagraphs (C), (D) and (E) a net operating loss for any taxable year ending after December 31, 1955, shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(C) In the case of a taxpayer which is a regulated transportation corporation (as defined in subsection (j)(1)), a net operating loss for any taxable year ending after December 31, 1955, shall (except as provided in subsection (j)) be a net operating loss carryover to each of the 7 taxable years following the taxable year of such loss.

(D) In the case of a taxpayer which has a foreign expropriation loss (as defined in subsection (k)) for any taxable year ending after December 31, 1958, the portion of the net operating loss for such year attributable to such foreign expropriation loss shall not be a net operating loss carryback to any taxable year preceding the taxable year of such loss and shall be a

net operating loss carryover to each of the 10 taxable years following the taxable year of such loss (or, with respect to that portion of the net operating loss for such year attributable to a Cuban expropriation loss, to each of the 15 taxable years following the taxable year of such loss).

(E) In the case of a taxpayer which is a domestic corporation qualifying under paragraph (3)(E), a net operating loss for any taxable year ending after December 31, 1966, and prior to January 1, 1969, shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 3 taxable years following the taxable year of such loss.

(F) In the case of a financial institution to which section 585, 586, or 593 applies, a net operating loss for any taxable year beginning after December 31, 1975, shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(G) In the case of a Bank for Cooperatives (organized and chartered pursuant to section 2 of the Farm Credit Act of 1933 (12 U.S.C. 1134)), a net operating loss for any taxable year beginning after December 31, 1969, shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(2) Amount of carrybacks and carryovers. Except as provided in subsections (i) and (j), the entire amount of

the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—

(A) with the modifications specified in subsection (d) other than paragraphs (1), (4), and (6) thereof; and

(B) by determining the amount of the net operating loss deduction—

(i) without regard to the net operating loss for the loss year or for any taxable year thereafter, and

(ii) without regard to that portion, if any, of a net operating loss for a taxable year attributable to a foreign expropriation loss, if such portion may not, under paragraph (1)(D), be carried back to such prior taxable year,

and the taxable income so computed shall not be considered to be less than zero. For purposes of this paragraph, if a portion of the net operating loss for the loss year is attributable to a foreign expropriation loss to which paragraph (1)(D) applies, such portion shall be considered to be a separate net operating loss for such year to be applied after the other portion of such net operating loss, and, if a portion of a foreign expropriation loss for the loss year is attributable to a Cuban expropriation loss, such portion shall be considered to be a separate foreign expropriation loss for such year to be applied after the portion of such foreign expropriation loss.

(3) Special rules.

* * *

(c) Net operating loss defined. For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) Modifications. The modifications referred to in this section are as follows:

(1) Net operating loss deduction. No net operating loss deduction shall be allowed.

(2) Capital gains and losses of taxpayers other than corporations. In the case of a taxpayer other than a corporation—

* * *

(5) Special deductions for corporations. No deduction shall be allowed under section 242 (relating to partially tax-exempt interest) or under section 922 (relating to Western Hemisphere trade corporations).

(6) Computation of deduction for dividends received, etc. The deductions allowed by sections 243 (relating to dividends received by corporations), 244 (relating to dividends received on certain preferred stock of public utilities), and 245 (relating to dividends received from certain foreign corporations) shall be computed without regard to section 246(b) (relating to limitation on aggregate amount of deductions); and the deduction allowed by section 247 (relating to dividends paid on certain preferred stock of public utilities) shall be computed without regard to subsection (a)(1)(B) of such section.

(e) Law applicable to computations. In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years, whether they begin before, on, or after January 1, 1954.

* * *

TITLE 28—JUDICIARY AND JUDICIAL PROCEDURE

* * *

§ 1255. Court of Claims; certiorari; certified questions

Cases in the Court of Claims may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted on petition of the United States or the claimant;

(2) By certification of any question of law by the Court of Claims in any case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions on such question.

(June 25, 1948, c. 646, § 1, 62 Stat. 928.)

* * *

APPENDIX H

REGULATIONS PROVISIONS INVOLVED

TITLE 26—INTERNAL REVENUE, 1954 CODE OF FEDERAL REGULATIONS

* * *

§ 1.172-1 Net Operating loss deduction.

(a) Allowance of deduction. Section 172(a) allows as a deduction in computing taxable income for any taxable year subject to the Code the aggregate of the net operating loss carryovers and net operating loss carrybacks to such taxable year. This deduction is referred to as the net operating loss deduction. The net operating loss is the basis for the computation of the net operating loss carryovers and net operating loss carrybacks and ultimately for the net operating loss deduction itself. The net operating loss deduction shall not be disallowed for any taxable year merely because the taxpayer has no income from a trade or business for the taxable year.

(b) Steps in computation of net operating loss deduction. The three steps to be taken in the ascertainment of the net operating loss deduction for any taxable year subject to the Code are as follows:

(1) Compute the net operating loss for any preceding or succeeding taxable year from which a net operating loss may be carried over or carried back to such taxable year.

(2) Compute the net operating loss carryovers to such taxable year from such preceding taxable years and the net operating loss carrybacks to such taxable year from such succeeding taxable years.

(3) Add such net operating loss carryovers and carrybacks in order to determine the net operating loss deduction for such taxable year.

(c) Statement with tax return. Every taxpayer claiming a net operating loss deduction for any taxable year shall file with his return for such year a concise statement setting forth the amount of the net operating loss deduction claimed and all material and pertinent facts relative thereto, including a detailed schedule showing the computation of the net operating loss deduction.

(d) Ascertainment of deduction dependent upon net operating loss carryback. If the taxpayer is entitled in computing his net operating loss deduction to a carryback which he is not able to ascertain at the time his return is due, he shall compute the net operating loss deduction on his return without regard to such net operating loss carryback. When the taxpayer ascertains the net operating loss carryback, he may within the applicable period of limitations file a claim for credit or refund of the overpayment, if any, resulting from the failure to compute the net operating loss deduction for the taxable year with the inclusion of such carryback; or he may file an application under the provisions of section 6411 for a tentative carryback adjustment.

(e) Law applicable to computations—(1) General. The following rules shall apply to all taxable years without regard to whether they began before, on, or after January 1, 1954:

(i) In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year.

(ii) The net operating loss for any taxable year shall be determined under the law applicable to that year without regard to the year to which it is to be carried and in which, in effect, it is to be deducted as part of the net operating loss deduction. In applying this rule, however, certain taxable years subject to the Internal Revenue Code of 1939 shall, to the extent provided in paragraphs (a) and (c) of § 1.172-2 and paragraphs (a) and (e) of § 1.172-3, be treated as though subject to the Internal Revenue Code of 1954.

(iii) The amount of the net operating loss deduction which shall be allowed for any taxable year shall be determined under the law applicable to that year.

* * *

§ 1.172-2 Net operating loss in case of a corporation.

(a) Modification of deductions. A net operating loss is sustained by a corporation in any taxable year beginning after December 31, 1953, if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 of the Internal Revenue Code of 1954 over gross income computed thereunder; this rule shall apply even though the loss year is otherwise subject to the Internal Revenue Code of 1939. In determining the excess of deductions over gross income for such purpose—

(1) Items not deductible. No deduction shall be allowed under—

(i) Section 172 for the net operating loss deduction,

(ii) Section 242 in respect of partially tax-exempt interest, and

(iii) Section 922 in respect of Western Hemisphere trade corporations;

(2) Dividends received. The 85-percent limitation provided by section 246 (b) shall not apply to the deductions otherwise allowed under—

(i) Section 243(a) in respect of dividends received from domestic corporations,

(ii) Section 244 in respect of dividends received on preferred stock of public utilities; and

(iii) Section 245 in respect of dividends received from foreign corporations; and

(3) Dividends paid. The deduction granted by section 247 in respect of dividends paid on the preferred stock of public

utilities shall be computed without regard to subsection(a)(1)(B) of that section.

(b) Illustration of principles. The application of paragraph (a) of this section may be illustrated by the following example:

* * *

§ 1.172-3 Net operating loss in case of a taxpayer other than a corporation.

* * *

§ 1.172-4 Net operating loss carrybacks and net operating loss carryovers.

(a) General provisions—(1) Years to which loss may be carried—(i) In general. In order to compute the net operating loss deduction the taxpayer must first determine the part of any net operating losses for any preceding or succeeding taxable years which are carrybacks or carryovers to the taxable year in issue.

(ii) Loss for taxable years ending after December 31, 1957. Except as provided in subdivisions (iii), (iv), (v), (viii), and (ix) of this subparagraph, § 1.172-12(a) and section 170(b)(1)(E), a net operating loss sustained in a taxable year ending after December 31, 1957, shall be carried back to the 3 preceding taxable years and carried over to the 5 succeeding taxable years.

(iii) Loss for taxable years for which certifications have been issued under the Trade Expansion Act of 1962. A net operating loss sustained in a taxable year ending on or after December 31, 1962, for which a certification has been issued under section 317(a) of the Trade Expansion Act of 1962 (76 Stat. 889) shall, subject to the provisions of section 172(b)(3)(A) and (B), § 1.172-9, and the exception in § 1.172-12(a) be carried back to the five preceding taxable years and, except as provided in subdivision (iv) of this subparagraph, shall be carried over to the five succeeding taxable years.

(iv) Loss of a regulated transportation corporation. Except as provided in subdivision (v) of this subparagraph and § 1.172-12(a) a net operating loss sustained in a taxable year ending after December 31, 1955, by a taxpayer which is a regulated transportation corporation (as defined in section 172(j)(1)) shall, subject to the provisions of section 172(j) and § 1.172-10, be carried back to the taxable years specified in subdivision (ii), (iii), or (vi) of this subparagraph, whichever is applicable, and shall be carried over to the seven succeeding taxable years.

(v) Loss attributable to foreign expropriation. If the provisions of section 172(b)(3)(C) and § 1.172-11 are satisfied, the portion of a net operating loss sustained in a taxable year ending after December 31, 1958, attributable to a foreign expropriation loss (as defined in section 172(k)) shall not be a net operating loss carryback to any taxable year preceding the taxable year of such loss and shall be a net operating loss carryover to each of the ten taxable years following the taxable year of such loss.

* * *

(viii) Loss of a financial institution. A net operating loss sustained in a taxable year beginning after December 31, 1975, by a taxpayer to which section 585, 586, or 593 applies shall be carried back (except as provided in § 1.172-12(a)) to the 10 preceding taxable years and shall be carried over to the 5 succeeding taxable years.

(ix) Loss of a Bank for Cooperatives. A net operating loss sustained in a taxable year beginning after December 31, 1969, by a taxpayer which is a Bank for Cooperatives (organized and chartered pursuant to section 2 of the Farm Credit Act of 1933 (12 U.S.C. 1134)) shall be carried back (except as provided in § 1.172-12(a)) to the 10 preceding taxable years and shall be carried over to the 5 succeeding taxable years.

(2) Periods of less than 12 months. A fractional part of a year which is a taxable year under sections 441(b) and

7701(a)(23) is a preceding or a succeeding taxable year for the purpose of determining under section 172 the first, second, etc., preceding or succeeding taxable year.

(3) Amount of loss to be carried. The amount which is carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the taxable (or net) income for other taxable years, preceding such taxable year, to which it may be carried back or carried over. For the purpose of determining the taxable (or net) income for any such preceding taxable year, the various net operating loss carryovers and carrybacks to such taxable year are considered to be applied in reduction of the taxable (or net) income in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year.

* * *

(b) Portion of net operating loss which is a carryback or a carryover to the taxable year in issue—(1) Manner of computation. **(i)** A net operating loss shall first be carried to the earliest of the several taxable years for which such loss is allowable as a carryback or a carryover, and shall then be carried to the next earliest of such several taxable years, etc. Except as provided in § 1.172-11, the entire net operating loss shall be carried back to such earliest year.

(ii) The portion of the loss which shall be carried to any of such several taxable years subsequent to the earliest taxable year is the excess of such net operating loss over the sum of the aggregate of the taxable incomes (computed as provided in § 1.172-5) for all of such several taxable years preceding such subsequent taxable year which are subject to the Internal Revenue Code of 1954 and the aggregate of the net incomes (computed as provided in 26 CFR (1939) 39.122-4(c) Regulations 118) or in the corresponding section of prior applicable regulations for all of such preceding taxable years which are subject to the Internal Revenue Code of 1939.

(iii) If, for any taxable year ending after December 31, 1958, a portion of the net operating loss is attributable to a foreign expropriation loss (as defined in section 172(k)), and if an election under paragraph (c) of § 1.172-11 is made with respect to such portion of the net operating loss, then see § 1.172-11 for the separate treatment of such portion of the net operating loss.

* * *

§ 1.172-5 Taxable income which is subtracted from net operating loss to determine carryback or carryover.

(a) Taxable year subject to the Internal Revenue Code of 1954. The taxable income for any taxable year subject to the Internal Revenue Code of 1954 which is subtracted from the net operating loss for any other taxable year to determine the portion of such net operating loss which is a carryback or a carryover to a particular taxable year is computed with the modifications prescribed in this paragraph. These modifications shall be made independently of, and without reference to, the modifications required by §§ 1.172-2(a) and 1.172-3(a) for purposes of computing the net operating loss itself.

(1) Modifications applicable to corporations only. In the case of a corporation the deductions provided by section 242 (relating to partially tax-exempt interest) and by section 922 (relating to Western Hemisphere trade corporations) shall not be allowed.

(2) Modifications applicable to unincorporated taxpayers only.

* * *

(3) Modifications applicable to all taxpayers. In the case either of a corporation or of a taxpayer other than a corporation—

(i) Net operating loss deduction. The net operating loss deduction for such taxable year shall be computed by taking into account only such net operating losses otherwise allowable as carrybacks or carryovers to such taxable year as were sustained in taxable years preceding the taxable year in which the taxpayer sustained the net operating loss from which the taxable income is to be deducted. Thus, for such purposes, the net operating loss for the loss year or any taxable year thereafter shall not be taken into account.

* * *

APPENDIX I

PAGE 1 OF PLAINTIFF'S EXHIBIT NO. 2: 1964 U. S. CORPORATION INCOME TAX RETURN OF KOLLSMAN INSTRUMENT CORPORATION

GROSS INCOME

1. Gross receipts *** Less: Returns and allowances ***	$41,324,172.61
2. Less-Cost of goods sold	36,120,653.24
3. Gross profit	5,203,519.37
* * *	
6. Other interest	68,252.23
7. Rents	6,094.20
8. Royalties	137,761.26
9. Net gains (losses) from separate Schedule D	30,338.06
10. Other income (attach schedule)	67,474.42
11. TOTAL income, lines 3 through 10	5,513,439.54

DEDUCTIONS

12. Compensation of officers (Schedule E)	175,667.12
13. Salaries and wages (not deducted elsewhere)	1,868,959.20
14. Repairs (do not include cost of improvements or capital expenditures)	129,641.96
15. Bad debts (from Schedule F if reserve method is used)	3,798.31
16. Rents	747,367.74
17. Taxes (attach schedule)	978,421.94
18. Interest	337,669.91
* * *	
22. Depreciation (Schedule G)	590,693.61
* * *	
24. Advertising	28,390.18
25. (a) Pension, profit-sharing, stock bonus, annuity plans	424,548.02
* * *	
26. Other deductions (attach schedule)	1,141,787.73
27. TOTAL deductions in lines 12 through 26	6,426,945.72
28. Taxable income before net operating loss deduction (line 11 less line 27)	(913,506.18)
29. Less: (a) Net operating loss deduction	
(b) Special deductions (Schedule I)	
30. Taxable income (line 28 less line 29) [Loss]	(913,506.18)

APPENDIX J

PLAINTIFF'S EXHIBIT NO. 9: CLAIM FOR REFUND OF 1961 INCOME TAXES BY REASON OF AN INCREASED NET OPERATING LOSS FOR 1964

NAME OF TAXPAYER: KOLLSMAN INSTRUMENT CORPORATION AMOUNT TO BE REFUNDED: $842,634.04

* * *

k. The claimant believes that this claim should be allowed for the following reasons:

1. There were erroneously included in the 1964 income of Kollsman Instrument Corporation ("Taxpayer") the amount of $1,708,000 for the following reasons:

During the years 1963, 1964 and 1965, Taxpayer was performing services for the United States Air Force in the development of AM/USQ-28 Geodetic and Photo Mapping System. As a result of those services, the Taxpayer recorded upon its books of account amounts attributable to the performance of said services during those years as follows:

Year	Amount of Claim
1963	$1,179,326
1964	1,750,497
1965	1,537,520
	$4,467,343

As a result, at the opening of business on January 1, 1966, Accounts Receivable of Taxpayer included the aforementioned amount of $4,467,343 which Taxpayer had included among its assets in the belief that all of the events had occurred which fixed the right of the Taxpayer to receive income from those services and in the further belief that the amount of that claim could be determined with reasonable accuracy.

During 1966, the Taxpayer attempted to procure from the United States Air Force an admission affirming that it did in fact owe the Taxpayer the amount so recorded on its books of account; but this attempt as unsuccessful when on January 10, 1966 a determination was made by the Contracting Officer that Taxpayer only had a right to receive the amount of $108,343 instead of the aforementioned amount of $4,467,343 which was determined as follows:

Year	Applicable to Claim	Determined to be Allowed	Balance
1963	$1,179,326	$29,326	$1,150,000
1964	1,750,497	42,497	1,708,000
1965	1,537,520	36,520	1,501,000

Accordingly, in computing its taxable income for 1966, the Taxpayer eliminated from its assets the amount of $4,359,000 and charged off the claim which it had recorded against the United States Air Force. The amount of $4,359,000 was the adjusted basis of said portion of the claim as determined by the application of Section 1011 of the Internal Revenue Code of 1954.

Although the Taxpayer believes that the aforementioned treatment is proper in the circumstances, it also recognizes the alternative possibility that the following provisions of Reg. Sec. 1.451-1(a) might apply:

> "* * * (I)f, in case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. * * * (I)f a Taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom." * * *

This claim for refund is filed in an attempt to comply with the above Regulation Provision and is predicated upon the possibility that the $1,708,000 which the Taxpayer included among its assets on account of the aforementioned claim in the year 1964 should not have been so included but rather should have reduced the 1964 taxable income of the Taxpayer.

2. There was erroneously omitted in the computation of Taxpayer's 1964 taxable income, depreciation and amortization deductions in the amount of $36,226.31.

There is presently pending in the Tax Court of the United States the case of Kollsman Instrument Corporation v. C.I.R., Docket No. 6605-65, which concerns the taxable years 1961-1962. Included as an issue in that case is the validity of the Commissioner's disallowance of the following amounts which the Taxpayer claimed as deductions for the years indicated:

	1961	1962
Repairs	$194,704.95	$11,070.00
Moving and Rearranging	134,665.23	44,928.00
	$329,370.18	$55,998.00

If the Respondent is upheld on the above issues, in that case, the Taxpayer will be entitled to the depreciation and amortization for 1964 in the amount of $36,226.31.

COMPUTATION OF INCOME TAX REFUND	Income Tax
1. Tax withheld	$2,000,000.00
2. Estimated tax paid	879,177.78
3. Tax paid with original return	
4. Any additional income tax paid	
5. Total tax paid (Add lines 1-4)	$2,879,177.78
6. Less: Your computation of correct tax	1,561,520.53
7. Amount of overpayment	1,317,657.25
8. Amount previously refunded	475,023.21
9. Net overpayment	$ 842,634.04

Attached as Exhibit I

EXHIBIT I

KOLLSMAN INSTRUMENT CORPORATION

COMPUTATION OF CORRECTED TAX LIABILITY
YEAR—1961

Taxable Income			$5,676,630.10
Net Operating Loss (Form 1120)	$ 913,506.18		
Add-As Attached ..	$1,708,000.00		
	36,226.31	1,744,226.31	2,657,732.49
Year—1961 As Corrected			$3,018,897.61
Tax on Above 52% Less $5,500.00			$1,564,326.76
Less—Foreign Tax Credit			2,806.23
Corrected Tax Liability			$1,561,520.53
Tax as Paid—Year 1961	$2,879,177.78		
Less: Per Form 1139 Refund	(475,023.21)		
Tax as Previously Adjusted			$2,404,154.57
Amount to be Refunded			$ 842,634.04

APPENDIX K

DEFENDANT'S EXHIBIT 21: LETTER DATED MAY 9, 1969, FROM THE REGIONAL COUNSEL OF THE INTERNAL REVENUE SERVICE *RE* THE 1961 TAX COURT CASE OF KOLLSMAN INSTRUMENT CORPORATION, DOCKET NO. 6605-65

Paul A. Teschner, Esq.
Pope, Ballard, Uriell, Kennedy
Shepard & Fowle
69 West Washington Street
Chicago, Illinois 60602

In re: Kollsman Instrument Corporation
Docket No. 6605-65

Dear Mr. Teschner:

There are enclosed an original and four copies each of a stipulation and decision which reflect a basis for settlement proposed in the above-entitled case. Please execute the original and three copies of each and return them to this office at the earliest practical date. The extra copies are for your files.

The proposal for settlement is subject to acceptance on behalf of the Commissioner of Internal Revenue and the documents are of no force or effect prior to such acceptance. We will file the settlement documents with the Tax Court only if the Joint Committee on Internal Revenue Taxation approves the refund made to your client for 1961.

We have also enclosed five copies of a Collateral Agreement. If you are in agreement therewith, please have your client sign and return four copies to this office. The extra copy is for your files.

On September 12, 1967, the petitioner filed an amendment to petition in the subject case. In that document, petitioner alleged that it had erroneously included in its total income for the taxable year ended 1964, the amount of $1,708,000.00.

On November 2, 1967, the respondent filed an answer to amendment to petition wherein the allegations concerning the $1,708,000.00 were denied. On June 20, 1968, the petitioner filed a reply to answer to amendment to petition. Contained therein, is the admission that the denial of respondent with respect to paragraph 5.(n)(5) of amendment to petition was correct and it is stated "... further admits that the Petitioner properly included in its total income for its taxable year ended December 31, 1964, the amount of $1,708,000.00 attributable to the performance of services for the United States Air Force in the development of AN/USQ—28 Geodetic and Photo Mapping System during its taxable year ended December 31, 1964."

Actually, the respondent did not make such allegations which are purportedly being admitted in the aforesaid reply filed by the petitioner. Although we have some question as to the correctness of filing a reply in this case under the rules of the Court, we did not pursue the matter but we do wish it to be clearly understood that we are in no way to be held to be agreeing to the allegations in the reply to answer to amendment to petition filed by the petitioner on June 20, 1968.

In the amendment to petition filed on September 12, 1967, it is alleged in paragraph 2.(n)(5)(d) that the petitioner in computing its taxable income for 1966 eliminated from its assets and charged off the amount of $1,708,000.00. Since the year 1966 is not before the Court, we have not given any consideration to the correctness of deducting the $1,708,000.00 in 1966 or in any other year. Our sole consideration on this issue is whether or not 1964's net operating loss was understated by the $1,708,000.00.

In conferences with representatives of the Appellate Division and this office, the petitioner was requested to prove its allegations concerning the $1,708,000.00. It is the respondent's view that satisfactory evidence was not submitted and accordingly, respondent would not agree that the error as alleged in the petition was committed.

Please address your correspondence in connection with the above matter to me, for the attention of Mr. James F. Kennedy.

Very truly yours,

FRANK C. CONLEY
Regional Counsel

By: GEORGE T. DONOGHUE, JR.
George T. Donoghue, Jr.
Assistant Regional Counsel

Enclosures:
As stated above

APPENDIX L

PLAINTIFF'S EXHIBIT NO. 8: CLAIM FOR REFUND OF 1960 INCOME TAXES BY REASON OF AN INCREASED NET OPERATING LOSS FOR 1963

NAME OF TAXPAYER: KOLLSMAN INSTRUMENT CORPORATION. AMOUNT TO BE REFUNDED: $618,402.56

* * *

k. The claimant believes that this claim should be allowed for the following reasons:

1. There was erroneously included in the 1963 income of Kollsman Instrument Corporation ("Taxpayer") the amount of $1,150,000 for the following reasons:

During the years 1963, 1964 and 1965, Taxpayer was performing services for the United States Air Force in the development of AN/USQ-28 Geodetic and Photo Mapping System. As a result of those services, the Taxpayer recorded upon its books of account amounts attributable to the performance of said services during those years as follows:

Year	Amount Of Claim
1963	$1,179,326
1964	1,750,497
1965	1,537,520
	$4,467,343

As a result, at the opening of business on January 1, 1966, Accounts Receivable of Taxpayer included the aforementioned amount of $4,467,343 which Taxpayer had included among its

assets in the belief that all of the events had occurred which fixed the right of the Taxpayer to receive income from those services and in the further belief that the amount of that claim could be determined with reasonable accuracy.

During 1966, the Taxpayer attempted to procure from the United States Air Force an admission affirming that it did in fact owe the Taxpayer the amount so recorded on its books of account; but this attempt was unsuccessful when on January 10, 1966 a determination was made by the Contracting Officer that Taxpayer only had a right to receive the amount of $108,343 instead of the aforementioned amount of $4,467,343 which was determined as follows:

Year	Applicable To Claim	Determined to Be Allowed	Balance
1963	$1,179,326	$29,326	$1,150,000
1964	1,750,497	42,497	1,708,000
1965	1,537,520	36,520	1,501,000

Accordingly, in computing its taxable income for 1966, the Taxpayer eliminated from its assets the amount of $4,359,000 and charged off the claim which it had recorded against the United States Air Force. The amount of $4,359,000 was the adjusted basis of said portion of the claim as determined by the application of Section 1011 of the Internal Revenue Code of 1954.

Although the Taxpayer believes that the aforementioned treatment is proper in the circumstances, it also recognizes the alternative possibility that the following provisions of Reg. Sec. 1.451-1(a) might apply:

> "* * * (I)f, in case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. * * * (I)f a Taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom." * * *

This claim for refund is filed in an attempt to comply with the above Regulation Provision and is predicated upon the

possibility that the $1,150,000 which Taxpayer included among its assets on account of the aforementioned claim in the year 1963 should not have been so included but rather should have reduced the 1963 taxable income of the Taxpayer.

2. There was erroneously omitted, in the computation of Taxpayer's 1963 taxable income, depreciation and amortization deductions in the amount of $39,235.69.

There is presently pending in the Tax Court of the United States the case of Kollsman Instrument Corporation v. C.I.R., Docket No. 6605-65, which concerns the taxable years 1961-1962. Included as an issue in that case is the validity of the Commissioner's disallowance of the following amounts which the Taxpayer claimed as deductions for the years indicated:

Year	1961	1962
Repairs	$194,704.95	$11,070.00
Moving & rearranging	134,665.23	44,928.00
	$329,370.18	$55,998.00

If the Respondent is upheld on the above issues, in that case, the Taxpayer will be entitled to the depreciation and amortization for 1963 in the amount of $39,235.69.

COMPUTATION OF INCOME TAX REFUND	Income Tax
1. Tax withheld	
2. Estimated tax paid	400,000.00
3. Tax paid with original return	3,016,230.16
4. Any additional income tax paid	248.72
5. Total tax paid (Add lines 1-4)	3,416,478.88
6. Less: Your computation of correct tax	1,727,108.11
7. Amount of overpayment	1,689,370.77
8. Amount previously refunded	1,070,968.21
9. Net overpayment	618,402.56

Attached as Exhibit I

Exhibit I.

KOLLSMAN INSTRUMENT CORPORATION

COMPUTATION OF CORRECTED TAX LIABILITY
YEAR—1960

Taxable income as corrected—			
Per R.A.R.—Year 1960			$6,584,364.60
Net operating loss—1963—			
Per Form 1120	$2,059,554.26		
Add—as attached . $1,150,000.00			
" "	39,235.69	1,189,235.69	3,248,789.95
Year 1960 income as corrected			$3,335,574.65
Tax on above 52% less $5,500.00			$1,728,998.82
Alternative tax			
Taxable income as corrected			$3,335,574.65
Less—long term gain (Per R.A.R.—1960)			(1,648.33)
			3,333,926.32
Tax—52% less $5,500.00			1,728,141.69
Add—25% of 1,648.33			412.08
Alternative tax			1,728,553.77
Less—foreign tax credit			1,445.66
Corrected tax liability			1,727,108.11
Tax—(Per R.A.R.—1960)	3,416,478.88		
Less: Per Form 1139—Refund	(1,070,968.21)		
Tax as previously adjusted			2,345,510.67
Amount to be refunded			$ 618,402.56

APPENDIX M

DEFENDANT'S EXHIBIT NO. 6: "30-DAY LETTER" DATED FEBRUARY 28, 1972 TO KOLLSMAN INSTRUMENT CORPORATION AND PORTIONS OF "T-LETTER" ATTACHED THERETO

Department of the Treasury
District Director
Internal Revenue Service
Date Feb. 28 1972

Kollsman Instrument Corporation
575 Underhill Boulevard
Syosset, New York

Dear Taxpayer:

We have enclosed a copy of our examination report explaining why we believe an adjustment of your tax liability is necessary.

If you accept our findings, please sign and return the enclosed agreement or waiver form. If additional tax is due, you may want to pay it now. (Follow the enclosed instructions, please.)

If you do not accept our findings, we recommend that you request a hearing with the Appellate Division of the Regional Commissioner's office. If you prefer, you may request a conference with a member of our conference staff to discuss the proposed adjustments. The enclosed instructions concerning unagreed cases explain your appeal rights.

To arrange a conference or hearing, please submit a written protest in accordance with the enclosed instructions. If you request a hearing, we will forward your protest to the Appellate Division and they will contact you to schedule an appointment.

If we don't hear from you within 30 days, we will have no alternative but to process your case on the basis of the adjustments shown in the examination report. If you write us about your case, please use the above address and refer to the symbols in the upper right corner of this letter. A self-addressed envelope is enclosed for your convenience.

Thank you for your cooperation.

Sincerely yours,

/s/ ROGER C. BECK
Roger C. Beck
District Director

Enclosures:
Examination Report
Agreement or Waiver Form
Instructions
Envelope

[EXAMINATION REPORT]

[T8] * * *

The April 13, 1967 Claim was filed on the following two issues.

1) Additional depreciation and amortization allowable based on the capitalization of items and extended lines for depreciation per the 1961 and 1962 Revenue Agents Reports then in the protest stage. The appellate division final determination altered this and activated the claim filed June 17, 1969 which contained the corrected follow thru figure for these items. This has been allowed as claimed.

[T9]

2) A claimed overstatement of Accrued Income included in the 1963 year in the amount of 1,150,000.— on the

percentage of completion basis in connection with a U.S. Air Force Contract. (AF33(657)10256). This was in the nature of a protective claim. The year 1960 is also the refund year due to the Net Operating Loss Carryback from 1963. This claim is being denied for the reasons stated beginning at page T34 entitled "Reduction 1963-5 Claim Against U.S. Air Force Percentage Of Completion Method" and item (d) schedule 10(a) of this report. Taxpayer has agreed to this adjustment.

* * *

[T34] Reduction 1963-5 Claim Against U. S. Air Force

Percentage of Completion Method

In March 1963 Kollsman Instrument Corp. (KIC) entered into a negotiated fixed price contract (AF33(657)10256) U.S. Air Force in the amount of 6,718,480—for the fabrication of an airborne data collection and ground data processing subsystem to be completed by April 1964. Included in the above price were provisions for spare parts, special testing equipment etc known as AGE items. This was a pre-production contract (research, experimental and prototype development) followed on December 1964 (AF33(657)12859) by a production contract also at a fixed price. The former contract with which we are solely concerned herein was definitized in May 1963. During 1963 and 1964, however, changes in the contract were ordered in Contract Change Notification (CCN#1 (6/21/63) - #2 (11/29/63) - #3 (5/26/64)) which also extended the period of production.

In view of the long period of production and the large dollar amount of these programs, involving a relatively small quantity of deliverable end products (4 subsystems), KIC used [T35] an accounting procedure on the two contracts in the recording of sales and income similar to the percentage of completion method. Sales were accrued as costs were incurred with appropriate gross profit mark-ups on such costs applied on the basis of indicated program performance. The receivables,

and thus the taxable income reported, included elements of profit as well as costs under this procedure.

For the years *1963* and *1964* accrued sales were reported as follows

	(Basic Contract)	(AGE)	(Total)
1963	2,591,925	52,659	2,644,584
1964	3,847,247	137,270	3,984,517

The Revenue Agent in his examination for these years made no adjustment to sales, cost of sales or inventories thus *accepting* the *method* and the results. By this time it was evident that in view of the Contract Change Notification that costs would substantially exceed the fixed contract price. By the latter part of 1964 accrued basic sales had exceeded the basic contract price.

For the year 1965 cumulative costs incurred were to be accrued without [T36] mark up for profit. They were basic costs of 3,379,686–. Actually per the books & tax return a small loss resulted in 1965 from the total accrual which included AGE items. By this time although the total contract had a fixed price of 6,718,480 total income including AGE was recorded and reported as follows:

1963	2,644,584–
1964	3,984,517–
1965	3,513,686–
Total	$10,142,787

This reflected management's considered opinion, based on the directed contract changes and all other available data including discussions with the parties, that all additional costs would be promptly recovered. Such reporting method was also used in the company's annual report which emphasized the above factors. It thus held that all of the events had occurred which fixed the right to receive such income and that the

amount thereof could be determined with reasonable accuracy. Sec. 1-451-1(a) of the Income Tax Regulations.

[T37] In 1966 additional accruals of 152,536 and 468,866 were made for AGE and basic sales respectively for a total of $621,402–. However by this time differences developed as to the balance due on the contract and, although KIC appealed under the disputes articles of the contract to the Armed Services Board of Contract Appeals, it adjusted its taxable income for 1966 for the differences between its original accruals and what it deemed to be an unacceptable offer or an amount of 4,359,000–. This was deducted in the 1966 return as filed.

For book and annual report purposes prior year earnings were charged for a loss of 5,300,000–, which included additional estimated costs to complete of 941,000, less a Federal Income tax refund receivable of 2,500,000– or a net of 2,800,000–.

In addition to its adjustment for 4,359,000—in its 1966 return, KIC also filed claims for the years 1963 and 1964 as an "alternative possibility" predicated "upon the possibility" that amounts which taxpayer included among its assets in those [T38] years should not so have been treated. These were in effect protective claims within the period of limitation. It was also indicated to the examiner that, if necessary, a timely claim for 1965 would also be filed. The amount of adjustment in the claims was computed by applying to the total of the fixed basic contract price actual plus estimated costs to complete for total costs and arriving at an estimated loss of 4,359,000. This was after deduction for the Governments offer and resulted in the following based on the percentage loss to total cost computed at 45.5%.

Original Contract 10256	6,718,000-
Less: AGE items	568,000-
Balance	6,150,000-
Less: Value of Fixed Services	55,000-
Estimated Contract—Basic	6,095,000-
Estimated Plus Actual Costs	11,185,000-
Estimated Loss at Completion	5,090,000-
Percentage Loss to Total Cost	45.5%

[T39]

	1963	1964	1965
Accrued Sales—Basic	$2,591,925	$3,847,247	$3,379,165
Loss 45.5%	1,179,326	1,750,497	1,537,520
Less 1/10/66 offer	29,326	42,497	36,520
Adjustment	$1,150,000	$1,708,000	$1,501,000

The 1963 claim was received in this district. The 1964 claim, however, was associated with the 1964 return which was under consideration jointly with the Regional Counsel (Docket No. 6605-65) at the trial session of the Tax Court at Chicago. This was because the 1964 year had a carryback loss to the year 1961 which was in litigation. The 1964 return as previously noted had also been examined.

Since this was a new issue the Chief, Appellate Branch Office Midwest Region, Chicago, Ill., in letter dated Sept. 25, 1967, requested an information report from this office.

Under date of Dec. 4, 1967, Revenue Agent Harold Breitbart, who had [T40] examined the 1963 and 1964 returns and to whom the 1963 claim was assigned, replied with the requested information and an opinion that "the income of the contract in question was properly included in the years 1963, 1964 and 1965 and the adjustment subsequently determined, is deductible in the year 1967 when the dispute was finalized." This examiner concurs in that opinion, a copy of which is submitted with the workpapers, and so holds in this report in disallowing the claimed deduction of 4,359,000- for the year 1966.

Section 1-451-1(a) states in part that where an item of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which the determination is made. That the taxpayer was within the purview of the change in scope of the contract

under Standard Law applicable to contract changes is evidenced by the fact that in 1967 a settlement in the substantial sum of 2,000,000- was completed. This in a sense justifies taxpayer's judgement and interpretation of the [T41] contract more so in view of the necessity for funds, costs and the goodwill of a prime customer which pressures compromises of this type in spite of a strong case by the plaintiff. It should also be noted that both in the claim and in its use of a 1966 deduction taxpayer has not seen fit to abandon its original position that all of the events had occurred which fixed the right to receive the income and set the amount with reasonable accuracy.

In the case of Rohl-Connelly * * * it was held that under the percentage of completion method it is possible to have a profit in one year and a loss in another and that if the transaction was at "arms length" there may be an offsetting deduction to the extent of profit previously reported.

As verified by a telephone conversation with Regional Counsel James F. Kennedy, who was assigned to the 1964 case, and in writing by subsequent receipt of the action memorandum, the 1964 claim was withdrawn. Taxpayer has agreed to this adjustment and subsequently deducted the corrected applicable amount in 1967 giving full consideration to the [T42] 2,000,000 received. This on the original return as filed thus eliminating any rollover adjustment or overassessment. Finally taxpayer has agreed to and is withdrawing the claim for 1963 in part or as it relates to the Air Force Contract #10256. See the 1963 item (c) in this report.

The above determination also results in a conclusion most favorable to the Government inasmuch as the adjustment or deduction takes place in the latest possible year thereby eliminating the substantial interest factor in a refund or allowance in an earlier year for so large an amount.

This issue is further discussed in the related (Net Operating Loss Carryback) report of the consolidated return for the year 1967 of the parent corp (Standard Kollsman Industries Inc.) in which a *corrected loss* of 3,318,000- is allowed for that year.